## **AUDIT REPORT**



## CITY OF CLEVELAND EMPOWERMENT ZONE PROGRAM

CLEVELAND, OHIO

2003-CH-1016

APRIL 25, 2003

OFFICE OF AUDIT, REGION V CHICAGO, ILLINOIS



Issue Date

April 25, 2003

Audit Case Number

2003-CH-1016

TO: Roy A. Bernardi, Assistant Secretary for Community Planning and Development, D

FROM: Heath Wolfe, Regional Inspector General for Audit, Region V

SUBJECT: City of Cleveland

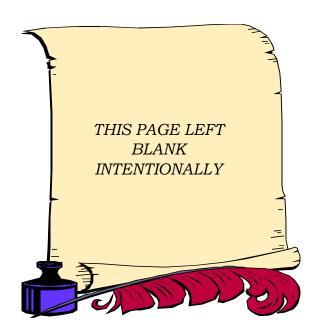
**Empowerment Zone Program** 

Cleveland, Ohio

We completed an audit of the City of Cleveland's Empowerment Zone Program. The audit was conducted based upon our survey results and requests from Congress. Our audit objectives were to determine whether the City: (1) efficiently and effectively used HUD (Section 108 Loan Guarantee and Economic Development Initiative Grant) funds for its Program; and (2) accurately reported the Program's accomplishments to HUD. The audit was part of our Fiscal Year 2002 Annual Audit Plan. The audit resulted in four findings.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us, for each recommendation without a management decision, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact Brent Bowen, Senior Auditor, at (614) 469-5737 extension 8277 or me at (312) 353-7832.



## **Executive Summary**

We completed an audit of the City of Cleveland's Empowerment Zone Program. Our audit objectives were to determine whether the City: (1) efficiently and effectively used HUD funds for its Program; and (2) accurately reported the Program's accomplishments to HUD. The audit was part of our Fiscal Year 2002 Annual Audit Plan. The audit was conducted based upon our survey results and two requests from Congress. The United States House of Representatives' Conference Report 107-272 directed HUD's Office of Inspector General to review the use of Zone funds and to report our findings to the Senate Appropriations Committee. The United States Senate's Report 107-43 also requested us to review the use of Zone funds and report our audit results to Congress.

We concluded the City did not maintain adequate oversight of its Program. Specifically, we determined:

- Controls over HUD funds were not adequate;
- \* Accomplishments were inaccurately reported;
- \* Zone residents were not benefiting from projects; and
- Program income was not properly managed.

Controls Over HUD Funds Were Not Adequate The City failed to maintain sufficient oversight of its HUD funds for its Program. All 10 of the projects we reviewed incurred inappropriate or unsupported expenditures of HUD funds for its Program. The City inappropriately used \$6,891,245 of HUD funds that did not benefit the City's Zone Program or were not matched with in-kind contributions. The City also lacked documentation to support that another \$4,744,824 in HUD funds paid benefited the City's Zone Program. As of November 2002, the City spent \$22,015,883 of HUD funds for its Zone Program on the 10 projects.

Accomplishments Were Inaccurately Reported

The City inaccurately reported the actual status and/or progress for eight of the 10 (80 percent) projects we reviewed from its June 30, 2001 Annual Report. The City's Report contained inaccuracies related to the eight projects' progress on projected outputs, milestones, and sources and/or uses of Program funds.

Zone Residents Were Not Benefiting From Projects The City used \$13,207,000 of the \$13,730,000 in HUD monies committed for its Program to fund three projects that have not provided benefits to Zone residents or benefited only 25 percent of Zone residents as of November 2002. The

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Program Income Was Not Properly Managed

Recommendations

three projects are scheduled for completion in December 2004. Since the three projects spent 96 percent of their HUD funds committed, benefits to Zone residents would be expected. However, this has not occurred.

The City did not follow its Economic Development Initiative Grant Agreement with HUD and its contract with Fairfax Renaissance Development Corporation to ensure that Program income was remitted to the City and deposited The account was into its loan repayment account. established by the City as security for the repayment of its Loan Guarantee. Fairfax Renaissance Development Corporation is fully funded with Initiative Grant funds from the City's Program and Community Development Block Grant funds. Fairfax receives fees for development Fairfax received \$1,162,263 in services it performs. development fees between 1996 and 2002.

We recommend that HUD's Assistant Secretary of Community Planning and Development assure that the City reimburses its Program for the inappropriate use of HUD funds and implements controls to correct the weaknesses cited in this report.

We presented our draft audit report to the City's Chief Assistant Director of Law and HUD's staff during the audit. We held an exit conference with the Director of the City's Department of Economic Development on March 14, 2003. The City disagreed that HUD funds were inappropriately used.

We included paraphrased excerpts of the City's comments with each finding (see Findings 1, 2, 3, and 4) and the summary of Zone projects reviewed (see Appendix B). The complete text of the comments is in Appendix C with the exception of 10 binders and three boxes that were not necessary for understanding the comments. A complete copy of the City's comments plus the 10 binders and three boxes were provided to HUD's Director of Renewal Communities/Empowerment

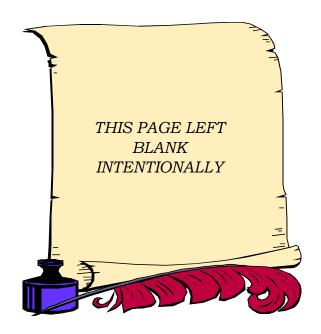
Zones/Enterprise Communities Initiative.

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## Introduction

The City of Cleveland was designated as an urban Supplemental Empowerment Zone effective December 21, 1994. The City was granted full Empowerment Zone status on January 31, 1998, but the designation did not become effective until January 1, 2000. The objective of the Empowerment Zone Program is to rebuild communities in poverty stricken inner City and rural areas by developing and implementing strategic plans. The plans are required to be based upon the following four principles: (1) creating economic opportunity for Zone residents; (2) creating sustainable community development; (3) building broad participation among community-based partners; and (4) describing a strategic vision for change in the community.

The Omnibus Budget Reconciliation Act of 1993 authorized the Program. The Reconciliation Act provided funding for the Program under Title 20 of the Social Security Act. The Program was initially designed to provide the Empowerment Zones authorized by the Reconciliation Act with \$250 million in tax benefits and \$100 million of Social Service Block Grant funds from the Department of Health and Human Services. In December 1994, HUD's former Secretary Cisneros designated six urban areas as Empowerment Zones and two urban areas as Supplemental Empowerment Zones. The two areas designated as Supplemental Zones were the Cities of Cleveland, Ohio and Los Angeles, California. The Cities were provided funding through HUD's Economic Development Initiative and Section 108 Loan Guarantee Programs. The Taxpayer Relief Act of 1997 authorized the two Supplemental Zones to receive tax benefits as provided under the Omnibus Budget Reconciliation Act of 1993. As of May 1, 2002, the City drew down and spent \$21,495,777 in Initiative Grant funds.

The City is a municipal corporation that is governed by a mayor and a city council. The City's fiscal year is January 1 through December 31. The City's Mayor is the Honorable Jane Campbell. During our audit, James DeRosa resigned effective February 3, 2003 as the Acting Director of the City's Empowerment Zone. Sharon Dumas is the current Acting Director of the City's Empowerment Zone. The City's Empowerment Zone Office is located at 3634 Euclid Avenue, Cleveland, Ohio.

**Audit Objectives** 

Audit Scope And Methodology Our audit objectives were to determine whether the City: (1) efficiently and effectively used HUD (Section 108 Loan Guarantee and Economic Development Initiative Grant) funds for its Program; and (2) accurately reported the Program's accomplishments to HUD.

We performed our on-site work between June and November 2002. To determine whether the City efficiently and effectively used HUD funds for its Program and accurately reported the Program's accomplishments to HUD, we interviewed staff from: HUD; the City; and administering entities of the City's Zone projects. Based

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upon the projects' reported expenditures as of April 30, 2002, we selected 10 of the City's 88 contracts for projects reported in its June 30, 2001 Annual Report. The following table shows the 10 projects we reviewed.

#### **Project**

- 1. Glenville Town Center, Ltd.
- 2. Quincy Place
- 3. Midtown Corporate Center
- 4. Lassi Enterprises, L.L.C.
- 5. Empowerment Zone Commercial Security
- **6. Fairfax Renaissance Development Corporation Operating**
- 7. Hough Area Partners In Progress Operating
- 8. Vocational Guidance Services' Job Match
- 9. Center for Employment and Training Cleveland, Inc.
- 10. IMR Global Orion Consulting, Inc. And The Reserve Network Bank Teller Job Training

To evaluate the City's Zone Program, we reviewed files and records maintained by: the City, HUD, and the administering entities. We also reviewed: 24 CFR Parts 85, 570, and 597; Office of Management and Budget Circular A-87; HUD's guidance and instructions for the Program; the City's June 2001 and June 2002 Annual Reports; the City's applications, agreements, and contracts; approved payment requests related to the projects; and the administering entities' voucher payments, monitoring files, and supporting documentation. We visited or met with representatives of the administering entities for nine of the 10 projects included in our audit to review their documentation, reports, and correspondence. We were unable to meet with representatives from Hough Area Partners In Progress since the organization ceased its operations.

The audit covered the period of January 1, 1999 to April 30, 2002. This period was adjusted as necessary. We conducted our audit in accordance with Generally Accepted Government Auditing Standards.

We provided a copy of this report to the City's Mayor and copies to its Director of the Empowerment Zone.

## Controls Over HUD Funds Were Not Adequate

The City of Cleveland failed to maintain sufficient oversight of its HUD funds for its Empowerment Zone Program. All 10 of the projects we reviewed incurred inappropriate or unsupported expenditures of HUD funds for its Program. The City inappropriately used \$6,891,245 of HUD funds that did not benefit the City's Program or were not matched with inkind contributions. The City also lacked documentation to support that another \$4,744,824 in HUD funds paid benefited the City's Program. As of November 2002, the City spent \$22,015,883 of HUD funds on the 10 projects. The problems occurred because the City lacked effective oversight and controls to assure that HUD funds for its Zone Program were used appropriately. As a result, HUD funds were not used efficiently and effectively.

Federal Requirements

Paragraph 1 of the Memorandum of Agreement for the City's Program requires the City to comply with 24 CFR Part 597. Paragraph 2 requires the City to comply with 24 CFR Part 570.

Paragraph 14 of the June 5, 1996 Contract For Section 108 Loan Guarantee Assistance for the City's Program states the Contract is incorporated in and made part of the Economic Development Initiative Grant Agreement.

Paragraph 1 of the Economic Development Initiative Grant Agreement, effective May 17, 1996, for the City's Program states the purpose of the Grant Agreement is to set forth the terms and conditions under which HUD will provide Grant funds to the City in connection with the approved projects in the City's Application. Paragraph 4 of the Grant Agreement states the City's Application is incorporated into the Grant Agreement. Paragraph 5 requires the City to assure and accept responsibility for compliance by other entities that it makes Grant funds available for the projects covered by the Grant Agreement.

Part II(C)(1) of the City's Supplemental Empowerment Zone HUD 108 Loan Guarantee Program Application dated April 26, 1995 to HUD states to be eligible as a Section 108 Business Loan, companies must show a record of profitability. Part II(C)(2) of the Application states to be eligible for an Acquisition and Development Revolving Loan, borrowers must show a record of profitability or, in the

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case of non-profit organizations, an ability to successfully manage fiduciary responsibilities.

24 CFR Part 85.36(f) requires grantees to perform a cost or price analysis in connection with every procurement action. 24 CFR Part 85.43(a)(2) states HUD may disallow all or part of the cost of an activity or action not in compliance with any term of an award, whether stated in a Federal statute or regulation, an assurance, in a State plan or application, a notice of award, or elsewhere.

24 CFR Part 570.200(a)(5) states costs incurred must be in conformance with Office of Management and Budget Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments. 24 CFR Part 570.502(a)(17) states recipients that are governmental entities will comply with 24 CFR Part 85.43.

Office of Management and Budget Circular A-87, Attachment A, requires principles to be established to assure that Federal awards bear their fair share of costs. Attachment A, paragraph C(1)(j), of the Circular states to be allowable under Federal awards, costs must be adequately documented. Paragraph C(3)(a) of the Circular's Attachment A states a cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received.

Office of Management and Budget Circular A-87, Attachment B, paragraph 18, states the cost of entertainment, including meals associated with social activities, are unallowable.

24 CFR Part 570.203 states guidelines for selecting activities to assist are provided at 24 CFR Part 570.209. The grantee must ensure that the appropriate level of public benefit will be derived pursuant to those guidelines before obligating funds.

24 CFR Part 570.209(b) states a grantee is responsible for making sure that at least a minimum level of public benefit is obtained from the expenditure of HUD funds. 24 CFR Part 570.209(b)(3) states an activity will be considered by HUD to provide insufficient public benefit and may under no

circumstances be assisted with HUD funds when the amount of HUD assistance exceeds \$50,000 per full-time equivalent permanent job created or retained or an activity consists of the acquisition of land for which the specific proposed use has not yet been identified.

24 CFR Part 597.200(e) states the Strategic Plan may not include any action to assist an establishment in relocating from outside the nominated urban area to the nominated urban area unless the assistance is for the establishment of a new branch, affiliate, or subsidiary that will not result in a decrease of the establishment's employment in the area of original location or in any area where the existing entity conducts business operations and there is not reason to believe the new branch, affiliate, or subsidiary is being established with the intention of closing down the operations of the existing entity in the area of its original location or in any other area where the existing entity conducts business operations.

Oversight Of Zone Funds Was Not Adequate

The City did not maintain adequate oversight and controls for all 10 projects we reviewed. Specifically, the City and/or the projects' administering entities used \$6,891,245 of HUD funds that did not benefit the City's Program or were not matched with in-kind contributions. The City and the projects' administering entities lacked sufficient documentation to support that another \$4,744,824 of HUD funds paid benefited the City's Program. The following table shows the amount of inappropriate and unsupported HUD funds for the City's Program for the 10 projects and the page number where a detailed summary of each project is located in this report.

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Project	HUD Funds Spent as of November 2002	Inappropriate Expense	Unsupported Expense	Page Number
Quincy Place	\$4,707,000	\$3,965,338	\$ 0	49
Midtown Corporate Center	3,000,000	277,567	2,754,996	59
Lassi Enterprises, L.L.C.	2,000,000	2,000,000	0	66
<b>Empowerment Zone Commercial Security</b>	2,000,000	0	1,954,676	71
Fairfax Renaissance Development Corporation Operating	1,590,071	328,636	0	74
Center For Employment Training – Cleveland, Inc.	300,000	176,100	33,300	80
Vocational Guidance Services' Job Match	850,936	112,388	0	84
IMR Global – Orion Consulting Inc. And The Reserve Network Bank Teller Job Training	85,652	25,095	0	90
Glenville Town Center, Ltd.	6,500,000	6,121	0	44
Hough Area Partners In Progress Operating	982,224	0	1,852	94
Totals	\$22,015,883	<u>\$6,891,245</u>	\$4,744,824	

Zone Funds Were Inappropriately Used The City and/or the projects' administering entities used \$6,891,245 of HUD funds that did not benefit the City's Program or were not matched with in-kind contributions. For example, the City inappropriately used \$3,677,000 in Loan Guarantee funds for its Program when it entered into a loan and grant agreement with Fairfax Renaissance Development Corporation, a non-profit corporation, for the Quincy Place project. The project is categorized as a Section 108 Business Loan. The City's Supplemental Empowerment Zone HUD 108 Loan Guarantee Program Application dated April 26, 1995 to HUD does not allow non-profit corporations to be funded as a Section 108 Business Loan.

Furthermore, Fairfax Renaissance Development Corporation, the administering entity for the Quincy Place project, inappropriately used HUD funds from the City's Program to purchase land and build an office building to provide rental office space in the Zone. Fairfax maintains its offices in 11 percent of the building and the County of Cuyahoga rents the remaining 89 percent of the office building's space for its Family Service Center. The County's Family Service Center maintains 154 employees in the Quincy Place project. Fortyeight (31.2 percent) of the employees relocated from the

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office at 1641 Payne Avenue, which is outside the Zone. The Interim Center Manager for the County's Employment and Family Services in Fairfax said the 48 employees were not replaced at the office located at 1641 Payne Avenue. The City entered into the contract for the Quincy Place project with full knowledge that the County's Family Service Center was going to relocate employees from outside the Zone to the Zone. Therefore, Fairfax inappropriately used \$1,307,039 of HUD funds (\$1,021,029 in Loan Guarantee funds and \$286,010 in Initiative Grant funds) from the City's Zone Program. The City's use of funds did not meet 24 CFR Part 597.200(e).

Fairfax Renaissance Development Corporation also inappropriately used \$2,328 of Initiative Grant funds from the City's Program to pay for entertainment expenses. The expenses included \$1,155 for the catering of a topping off ceremony and \$1,173 for the catering of a groundbreaking ceremony. This was contrary to paragraph 18 in Attachment B of Office of Management and Budget Circular A-87.

The City Lacked Sufficient Documentation To Support The Use Of Zone Funds

The City and the projects' administering entities lacked sufficient documentation to support that another \$4,744,824 of HUD funds paid benefited the City's Zone Program. For example, the City executed a Loan Agreement on June 30, 1998 with Midtown Associates, L.L.C., the administering entity for the Midtown Corporate Center project, for \$3,000,000 in Loan Guarantee funds for the City's Program. As of February 2003, Midtown Associates, L.L.C. made payments reducing the principal by \$47,164. The City lacked documentation to support that it performed an analysis to determine that a minimum level of public benefit would be achieved by the Midtown Corporate Center project as required by 24 CFR Part 570.209(b). Specifically, the City did not determine whether the project's assistance would exceed \$50,000 per full-time equivalent, permanent job created or retained. Therefore, the City was required to show that the project would create or retain at least 60 (\$3,000,000 divided by \$50,000) jobs.

The June 30, 1998 Loan Agreement between the City and Midtown Associates, L.L.C., the administering entity of the Midtown Corporate Center, required Midtown to achieve

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the job creation and retention requirements by June 30, 2001. As of October 2002, documentation maintained by the City and Midtown Associates, L.L.C. showed that only four (6.7 percent) jobs were created or retained. Therefore, Midtown used \$2,754,996 (93.3 percent of \$3,000,000 minus \$47,164) of Loan Guarantee funds from the City's Program without creating or retaining jobs. The former Acting Director of the City's Zone said the job creation standard was too difficult for the Midtown Corporate Center project to meet because the employees who work in the office buildings usually need special training or college degrees.

Office of Management and Budget Circular A-87, Attachment A, paragraph C(1)(j), states to be allowable under Federal awards, costs must be adequately documented

The problem occurred because the City lacked effective oversight and controls to assure HUD funds for its Program were used appropriately. As a result, HUD funds were not used efficiently and effectively.

#### **Auditee Comments**

[Excerpts paraphrased from the comments provided by the Director of the City's Department of Economic Development on our draft audit report follow. Appendix C, pages 99 to 102, 107 to 110, 112 to 115, and 127 to 129 contains the complete text of the comments for this finding.]

The Office of Inspector General's findings severely limits the Congressional intent and implementation of HUD's Program. The City takes exception to the Office of Inspector General's broad and overreaching conclusions in the report that indicate the City's use of HUD funds did not benefit the City's Program.

Ineligible costs are subject to modification based upon a future decision by HUD and the City providing additional supporting documentation. The Office of Inspector General cannot make a conclusion on the eligibility of costs based on the definition of ineligible costs in footnote 1 in

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Appendix A. Therefore, the City requests that footnote 1 in Appendix A by rewritten to state:

The costs are not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the cost. Ineligible cost requires a future decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.

The City disagrees that it failed to maintain sufficient oversight of HUD funds for its Program, inappropriately used HUD funds that did not benefit the City's Zone Program, and lacked documentation to support that \$4,850,646 in HUD funds paid benefited the City's Zone Program.

The City's Supplemental Zone HUD 108 Loan Guarantee Program Application dated April 26, 1995, the City's June 5, 1996 Contract For Section 108 Loan Guarantee Assistance, and Federal regulations allow Loan Guarantee funds to be used for community development and by non-The City's Loan Application does not profit entities. specifically state that projects funded as Section 108 Business Loans must be for-profit entities. Part II. paragraph 15(a), of the Contract for Loan Assistance states guaranteed loan funds shall be used by the Borrower to assist for-profit businesses, community-based development organizations, and non-profit organizations as subrecipients in carrying out economic development activities and projects as authorized under 24 CFR Part 570.703(i).

The Office of Inspector General incorrectly used a requirement that does not exist in the City's Loan Application and Contract For Loan Assistance. Part II(C)(2) of the application states to be eligible as an Acquisition and Development Revolving Loan, borrowers must show a record of profitability or, in the case of non-profit organizations, an ability to successfully manage fiduciary responsibilities.

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The Office of Inspector General inappropriately only uses 24 CFR Part 570.203(b) in its evaluation of the Quincy Place project. 24 CFR Part 570.703(i)(1) states Loan Guarantee funds may be used for economic development activities eligible under 24 CFR Part 570.203. The Office of Inspector General failed to include 24 CFR Part 570.203(a) in its analysis of the project. 24 CFR Part 570.203(a) states a recipient may use Loan Guarantee funds for special economic development activities carried out by non-profit sub-recipients.

The language contained in the Federal requirements and the City's Contract for Loan Assistance support the City making loans to non-profit entities. Therefore, it appears the Office of Inspector General misinterpreted the City's ability to loan monies to non-profits.

The City believes Fairfax Renaissance Development Corporation, the administering entity for the Quincy Place project, appropriately used HUD funds from the City's Program to purchase land and build an office building to provide rental office space in the Zone. The Office of Inspector General's concern is that the project reduced the County of Cuyahoga's employment outside the Zone when the County relocated its Family Service Center to the Quincy Place project.

The Office of Inspector General admitted that it never conducted an employment analysis to determine whether the County's employment outside the Zone decreased as result of the relocation of the County's Family Service Center. The Office of Inspector General did not demonstrate that the relocation of the Family Service Center reduced the County's employment at the original location or outside the Zone.

24 CFR Part 597 is not applicable to the City's Program. Therefore, the Office of Inspector General inappropriately applied the requirements of 24 CFR Part 597.200(e) to the Quincy Place project.

Fairfax Renaissance Development Corporation did not inappropriately use \$2,328 of Initiative Grant funds from the City's Program to pay for entertainment expenses for

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catering of a topping off ceremony and groundbreaking ceremony. The events were organized to promote the opening of a new community service facility for Zone residents. The events are allowable under Office of Management and Budget Circular A-87, Attachment B, paragraph 2. Therefore, the Office of Inspector General incorrectly applied Attachment B, paragraph 18, of the Circular.

The City requests the Office of Inspector General remove from the finding that Fairfax Renaissance Development Corporation inappropriately used HUD funds.

The City adequately planned for the Midtown Corporate Center project. The project achieved the mandatory public benefit criteria established by 24 CFR Part 570.

24 CFR Part 570.209(b)(3) states an activity will be considered by HUD to provide insufficient public benefit and may under no circumstances be assisted with HUD funds when the amount of HUD assistance exceeds \$50,000 per full-time equivalent permanent job created or retained or \$1,000 per low and moderate-income person which goods or services are provided by the activity. The projects met the public benefit criteria for goods or services to low and moderate-income persons.

The City requests the Office of Inspector General removes or reduces the recommendations in the finding based on the documentation provided by the City.

The City will implement steps to more fully assure: an efficient and effective Program; subrecipients use HUD funds appropriately and to benefit the Zone; the Zone complies with all applicable laws and regulations; resources are properly safeguarded; and the City understands, follows, and/or amends its Initiative Grant Agreement effective May 17, 1996 for its Program and its contract with subrecipients, where appropriate.

The City hired an outside consultant to review and analyze the Program's processes and controls to make any necessary recommendations.

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# OIG Evaluation Of Auditee Comments

The City did not maintain adequate oversight and controls for all 10 projects we reviewed, inappropriately used \$6,891,245 in HUD funds that did not benefit the City's Program, and lacked documentation to support that \$4,744,824 in HUD funds paid benefited the City's Zone Program.

Our findings are based on criteria contained in Federal requirements, the City's contracts with the projects' administering entities, and the administering entities' policies. If the City's use of HUD funds does not meet the applicable requirements, then the use of funds does not benefit the City's Program as established.

Ineligible costs are costs charged to a HUD-financed or insured program or activity that the auditor believes are not allowable by law, contract, or Federal, State, or local policies or regulations. Therefore, there is no need to change footnote 1 in Appendix A.

We agree that the City's Supplemental Zone HUD 108 Loan Guarantee Program Application, the City's June 5, 1996 Contract For Loan Guarantee Assistance, and Federal regulations allow Loan Guarantee funds to be used for community development and by non-profit entities. We also agree that Part II, paragraph 15(a), of the Contract for Loan Assistance states guaranteed loan funds shall be used by the Borrower to assist for-profit businesses, community-based development organizations, and non-profit organizations as sub-recipients in carrying out economic development activities and projects as authorized under 24 CFR Part 570.703(i).

We mistakenly used a document the former Acting Director of the City's Zone indicated was part of the City's application to HUD for the Program. We only used 24 CFR Part 570.203(b), because the document provided by the former Acting Director stated projects funded as Section 108 Business Loans must be eligible under 24 CFR Part 570.203(b) as direct assistance to for-profit entities.

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Therefore, we adjusted our report by including the City's application to HUD for the Program requires that projects funded as Section 108 Business Loans must be eligible under 24 CFR Part 570.203(b) as direct assistance to forprofit entities and included Part II(C)(1) and (2) of the City of Cleveland Supplemental Zone HUD 108 Loan Guarantee Program Application dated April 26, 1995 to HUD for the Program. Part II(C)(1) of the City's Loan Application states to be eligible as a Section 108 Business Loan, companies must show a record of profitability. II(C)(2) of the application states to be eligible as an Acquisition and Development Revolving Loan, borrowers must show a record of profitability or, in the case of nonprofit organizations, an ability to successfully manage fiduciary responsibilities. Therefore, since the City did not include that a non-profit organization was eligible for a Section 108 Business Loan as did for an Acquisition and Development Revolving Loan, non-profit corporations are not eligible for a Section 108 Business Loan.

We adjusted our audit report by removing that the City inappropriately used \$1,030,000 in Initiative Grant funds for its Program when it entered into a loan and grant agreement with Fairfax Renaissance Development Corporation, a non-profit corporation, for the Quincy Place project. Therefore, the City inappropriately used \$3,677,000 in Loan Guarantee funds for its Zone Program when it entered into the loan and grant agreement.

Fairfax Renaissance Development Corporation, the administering entity for the Quincy Place project, inappropriately used HUD funds from the City's Program to purchase land and build an office building to provide rental office space in the Zone.

We adjusted our audit report to state that 48 (31.2 percent) of the employees relocated from the office at 1641 Payne Avenue, which is outside the Zone. The Interim Center Manager for the County's Employment and Family Services in Fairfax said the 48 employees were not replaced at the office located at 1641 Payne Avenue.

We said in our exit conference with the City that we never conducted employment analysis to determine whether the

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County's total employment outside the Zone decreased as a result of the relocation of the County's Family Service The Interim Center Manager for the County's Employment and Family Services in Fairfax said the 48 employees were not replaced at the office located at 1641 Payne Avenue. 24 CFR Part 597.200(e) states the Strategic Plan may not include any action to assist an establishment in relocating from outside the nominated urban area to the nominated urban area unless the assistance is for the establishment of a new branch, affiliate, or subsidiary that will not result in a decrease of the establishment's employment in the area of original location or in any area where the existing entity conducts business operations and there is not reason to believe the new branch, affiliate, or subsidiary is being established with the intention of closing down the operations of the existing entity in the area of its original location or in any other area where the existing entity conducts business operations. Therefore, we were not required to determine whether the County's total employment outside the Zone decreased as a result of the relocation of the County's Family Service Center.

Paragraph 1 of the Memorandum of Agreement for the City's Program requires the City to comply with 24 CFR Part 597. Therefore, we appropriately apply the requirements of 24 CFR Part 597.200(e) to the Quincy Place project.

The City did not provide documentation that the catering of a topping off ceremony and groundbreaking ceremony were either advertising or public relations expenses. Therefore, Fairfax Renaissance Development Corporation inappropriately used \$2,328 of Initiative Grant funds from the City's Zone Program to pay for entertainment expenses for catering of a topping off ceremony and groundbreaking ceremony.

24 CFR Part 570.209(b)(3) states an activity will be considered by HUD to provide insufficient public benefit and may under no circumstances be assisted with HUD funds when the amount of HUD assistance exceeds \$50,000 per full-time equivalent permanent job created or retained.

The City's Implementation Plan for the HUD 108 Real Estate Loan Program, which includes the Midtown Corporate Center project, is contained in the City's June 30, 2001 Annual Report to HUD. The Report shows that the baseline for the project is the revitalization of distressed urban neighborhoods by offering loan and grant incentives to Zone businesses while creating job opportunity for residents. A milestone of the Implementation Plan is that the Zone will create and retain 1,500 jobs for Zone residents by providing low interest loans and grants to 250 businesses utilizing the One Stop Career Center and other labor force partners. Furthermore, one of the outputs of the Implementation Plan is to create or retain 1,500 Zone jobs from loans. The Implementation Plan does not refer to providing goods or services to individuals.

Furthermore, the former Acting Director for the City's Zone said on December 19, 2002 that the Midtown Corporate Center project must meet the public benefit criteria for job creation and retention.

The City lacked documentation to support that it performed an analysis to determine that a minimum level of public benefit would be achieved by the Midtown Corporate Center project as required by 24 CFR Part 570.209(b). Specifically, the City did not determine whether the project's assistance would exceed \$50,000 per full-time equivalent, permanent job created or retained. Therefore, the City was required to show that the project would create or retain at least 60 (\$3,000,000 divided by \$50,000) jobs.

The June 30, 1998 Loan Agreement between the City and Midtown Associates, L.L.C., the administering entity of the Midtown Corporate Center, required Midtown to achieve the job creation and retention requirements by June 30, 2001. As of October 2002, documentation maintained by the City and Midtown Associates, L.L.C. showed that only four (6.7 percent) jobs were created or retained. Therefore, Midtown used \$2,754,996 (93.3 percent of \$3,000,000 minus \$47,164) of Loan Guarantee funds from the City's Zone Program without creating or retaining jobs.

The City's hiring of an outside consultant to review and analyze the Program's processes and controls to make any

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necessary recommendations should benefit the City's Program.

The City needs to reimburse its Program \$6,901,750 from non-Federal funds for the inappropriate use of HUD funds for its Zone Program cited in this finding. The City also needs to provide documentation to support that the projects' administering entities used \$4,744,824 of HUD funds to benefit the City's Program. If adequate documentation cannot be provided, then the City should reimburse its Program from non-Federal funds for the appropriate amount.

The City needs to provide documentation to support that it performed an analysis to determine a minimum level of public benefit would be achieved by the Quincy Place, Midtown Corporate Center, Lassi Enterprises, L.L.C., and Glenville Town Center, Ltd. projects. If adequate documentation cannot be provided, then the City should reimburse its Program from non-Federal funds for the appropriate amount.

The City needs to implement procedures and controls to ensure that HUD funds for its Program are used efficiently and effectively.

The City needs to implement procedures and controls to ensure that an analysis to determine that a minimum level of public benefit would be achieved by Section 108 Business Loan and 108/Economic Development Initiative Acquisition and Development Loan projects funded with HUD funds from its Program.

The City needs to require the projects' administering entities to maintain documentation to support that HUD funds from its Program are used in accordance with Zone Program requirements.

#### Recommendations

We recommend that HUD's Assistant Secretary for Community Planning and Development assure the City of Cleveland:

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- 1A. Reimburses its Program \$6,891,245 from non-Federal funds for the inappropriate use of HUD funds for its Program cited in this finding.
- 1B. Provides documentation to support that Midtown Associates, L.L.C. (\$2,754,996), Uptown Cleveland Security Corporation (\$1,954,676), Center for Employment Training Cleveland, Inc. (\$33,300), and Hough Area Partners in Progress (\$1,852) used \$4,744,824 of HUD funds to benefit the City's Program. If adequate documentation cannot be provided, then the City should reimburse its Program from non-Federal funds for the appropriate amount.
- 1C. Provides documentation to support the City performed an analysis to determine that a minimum level of public benefit would be achieved by the Quincy Place, Midtown Corporate Center, Lassi Enterprises, and Glenville Town Center projects. If adequate documentation cannot be provided, then the City should reimburse its Program from non-Federal funds for the appropriate amount.
- 1D. Implements procedures and controls to ensure that HUD funds for its Program are used efficiently and effectively.
- 1E. Implements procedures and controls to ensure that an analysis to determine that a minimum level of public benefit would be achieved by Section 108 Business Loan and 108/Economic Development Initiative Acquisition and Development Loan projects funded with HUD funds from its Program.
- 1F. Requires the projects' administering entities to maintain documentation to support that HUD funds from its Program are used in accordance with Zone Program requirements.

We recommend that HUD's Assistant Secretary for Community Planning and Development:

1G. Ensures the Quincy Place, Lassi Enterprises, L.L.C., and Glenville Town Center, Ltd. projects meet the

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public benefit criteria by December 31, 2004. If HUD determines that the projects did not meet the public benefit criteria, then HUD should require the City to reimburse its Program the applicable amount from non-Federal funds.

## Accomplishments Were Inaccurately Reported

The City of Cleveland inaccurately reported the actual status and/or progress for eight of the 10 projects (80 percent) we reviewed from its June 30, 2001 Annual Report. The City's Report contained inaccuracies related to the eight projects' progress on projected outputs, milestones, and sources and/or uses of Program funds. The problems occurred because the City failed to maintain adequate controls over its Annual Report submitted to HUD. As a result, the City inaccurately reported the accomplishments of its Program to HUD.

Federal Requirements

Paragraph 5 of the Memorandum of Agreement for the City's Program requires the City to submit reports to HUD on the progress made in carrying out activities specified in the Strategic Plan in accordance with 24 CFR Part 597.400.

24 CFR Part 597.400 requires Empowerment Zones to submit periodic reports to HUD identifying actions taken in accordance with the Strategic Plan.

Page 2 of the Empowerment Zone and Enterprise Community Initiative Performance Measurement System guidance issued in April 2001 states that HUD is congressionally mandated to obtain performance reports from the Empowerment Zones. To accomplish this objective, the Zones are to report projects and progress via Performance Measurement System. Empowerment Zones are required to submit an Annual Report that includes information on their progress for the projected outputs, milestones, and funding in the Zones' Implementation Plans. Page 12 requires that sources and uses of funds reflect the total projected monies over the life of the project. Page 16 of the Performance Measurement System guidance states outputs are the results immediately created upon implementation of a project or program.

Accomplishments Were Inaccurately Reported

The City inaccurately reported the actual status and/or progress for eight of the 10 projects (80 percent) we reviewed from its June 30, 2001 Annual Report. The City's June 2001 Annual Report contained inaccuracies related to the eight projects' progress on projected outputs, milestones, and sources and/or uses of Program funds. The following table shows the inaccurate reporting by category

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for the eight projects and the page number in this report where a detailed summary for each project is located.

Project	Outputs	Milestones	Source(s) and/or Use(s) of Funds	Page Number
Glenville Town Center, Ltd.	X	X	X	44
Quincy Place	X	X	X	49
Midtown Corporate Center	X	X	X	59
Fairfax Renaissance Development Corporation Operating	X	X	X	74
Center for Employment Training – Cleveland, Inc.	X	X	X	80
Vocational Guidance Services' Job Match	X	X	X	84
IMR Global – Orion Consulting, Inc And The Reserve Bank Teller Job Training	X	X	X	90
<b>Hough Area Partners In Progress Operating</b>	<u>X</u>	<u>X</u>	X	94
Totals	<u>8</u>	<u>8</u>	<u>8</u>	

The City Inaccurately Reported Projects' Outputs

The City inaccurately reported eight projects' outputs. Outputs are the results immediately created upon completion of a project. For example, the City reported in its June 30, 2001 Annual Report for an output that 1,097 Zone resident jobs were created or retained by its HUD 108 Real Estate Loan Program projects. The City provided a schedule as support for the Zone resident jobs created or retained without supporting documentation. The schedule showed that 1,577 and 171 Zone resident jobs were created or retained from projects in its HUD 108 Real Estate Loan Program and by the Quincy Place project, respectively. Documentation maintained by the City and Fairfax Renaissance Development Corporation showed that no Zone resident jobs were created or retained as of June 30, 2001.

The City Inaccurately Reported Projects' Milestones The City inaccurately reported eight projects' milestones. Milestones are the major steps taken to implement a project. For example, the City inaccurately reported the actual progress for The Center for Employment Training – Cleveland, Inc. project's milestone in its June 30, 2001 Annual Report. The City reported the project was 50

percent complete as of June 30, 2001 in providing skill training and job placement for 2,000 Zone residents in the fields of welding, precision metals, shipping/receiving, and printing. Documentation maintained by the Center for Employment Training – Cleveland, Inc. showed that the milestone was only eight percent complete as of June 2001.

The City Inaccurately Reported Projects' Sources And Uses of Funds The City inaccurately reported eight projects' sources and/or uses of Program funds. Funds are the total projected monies over the life of a project. For example, the City reported in its June 30, 2001 Annual Report that Vocational Guidance Services' Job Match project used \$16,128,690. Documentation maintained by the City showed the project used only \$2,728,750 as of June 30, 2001.

The City Did Not Verify Annual Reports Submitted To HUD The inaccurate reporting occurred because the City did not verify the accuracy of the information included in the City's June 2001 Annual Report and the validity of the information maintained by the projects' administering entities. The City also could not provide adequate supporting documentation for information included in the 2001 Report. As a result, the City inaccurately reported the accomplishments of its Program to HUD.

### **Auditee Comments**

[Excerpts paraphrased from the comments provided by the Director of the City's Department of Economic Development on our draft audit report follow. Appendix C, pages 98, 99, 102, 103, 121, 125, and 136, contains the complete text of the comments for this finding.]

To the best of the City's knowledge, it accurately reported the information for the Vocational Guidance Services' Job Match project in its June 2001 Annual Report.

The City concurs that it can make improvements in its Annual Reports to HUD. The City prepared its June 30, 2001 Annual Report according to HUD's recommendation.

The City corrected the reporting format for its June 30, 2002 Annual Report. The City is currently gathering the appropriate information for future reporting.

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The City hired an outside consultant to review the Program's processes and controls to make any necessary recommendations and to assure that the City's Program continues to operate efficiently, effectively, and in full compliance with requirements. The City will implement procedures and controls to verify the accuracy of information in its Annual Reports to HUD and ensure that the staff responsible for preparing the Annual Report use actual verified accomplishments for each project in the Annual Report.

The City will implement steps to more fully assure: an efficient and effective Program; data included in the Annual Report is valid and reliable; and the Zone complies with all applicable laws and regulations.

# OIG Evaluation Of Auditee Comments

The City did not provide documentation to support that it accurately reported the information for the Vocational Guidance Services' Job Match project in its June 2001 Annual Report. Our audit work started in June 2002. Therefore, we based our review on the City's June 30, 2001 Annual Report which was the latest Report submitted to HUD.

The City's hiring of an outside consultant to review and analyze the Program's processes and controls to make any necessary recommendations and to assure that the City's Program continues to operate efficiently, effectively, and in full compliance with requirements should benefit the City's reporting of its Program's accomplishments.

The City needs to implement procedures and controls to verify the accuracy of information submitted to HUD for the City's Program.

The City needs to ensure that staff responsible for preparing its Annual Report for HUD uses the actual verified accomplishments to report each project.

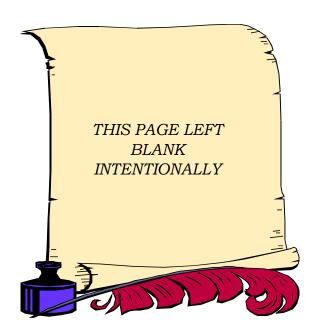
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## Recommendations

We recommend that HUD's Assistant Secretary for Community Planning and Development assure the City of Cleveland:

- 2A. Implements procedures and controls to verify the accuracy of information submitted to HUD for the City's Program.
- 2B. Ensures that staff responsible for preparing its Annual Report for HUD uses the actual verified accomplishments to report each project.

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# Zone Residents Were Not Benefiting From Projects

The City of Cleveland used \$13,207,000 of the \$13,730,000 in HUD monies committed for its Program to fund three projects that have not provided benefits to Zone residents or benefited only 25 percent of Zone residents as of November 2002. The three projects are scheduled for completion in December 2004. Since the three projects spent 96 percent of their HUD funds committed for the City's Zone Program, benefits to Zone residents would be expected. However, this has not occurred. The problem occurred because the City did not ensure that its Zone contracts for the Quincy Place and Glenville Town Center, Ltd. projects required the projects to create or retain jobs that will be predominantly held by Zone residents and that the Zone contract for Lassi Enterprises, L.L.C. required the majority of the jobs created or retained by the project to be held by Zone residents. We believe the City's use of HUD funds for the three projects does not meet its Initiative Grant Agreement. However, HUD must make a determination whether the City's use of HUD funds for its Zone Program was appropriate.

Federal Requirement

Zone Residents Were Not Benefiting From Projects Paragraph 13(3)(b) of the Economic Development Initiative Grant Agreement, effective May 17, 1996, for the City's Program states jobs created or retained by projects funded as Section 108 Business Loans will be predominantly held by residents of the Zone. Paragraph 13(3)(c) states a majority of the jobs created or retained by projects' funded as 108/Economic Development Initiative Acquisition and Development Loans for businesses will be held by Zone residents.

The City provided HUD monies for its Program to fund three projects that have not provided benefits to Zone residents or benefited only 25 percent of Zone residents as of November 2002. We believe the City's use of HUD funds from its Zone Program for the Quincy Place and Glenville Town Center, Ltd. projects does not meet its Initiative Grant Agreement requiring that jobs created or retained by projects funded as Section 108 Business Loans will be predominantly held by Zone residents. We believe the City's use of HUD funds for the Lassi Enterprises, L.L.C. project does not meet its Initiative Grant Agreement requiring that a majority of the jobs created or retained by projects' funded as 108/Economic Development Initiative Acquisition and Development Loans for businesses will be held by Zone residents.

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Based upon supporting documentation provided by the City and/or the projects' administering entities, the following table shows for each of the three projects as of October 2002: the actual start date; the projected completion date; HUD funds committed; HUD funds spent; total number of individuals served; actual number of Zone residents served; and the percentage of Zone residents served.

Project	Actual Start Date	Projected Completion Date	HUD Funds Committed To Project	HUD Funds Spent On Project	Total Number Of Jobs Created Or Retained	Number Of Zone Resident Jobs Created Or Retained	Percentage Of Zone Residents Jobs Created Or Retained
Quincy Place	2/1/99	12/31/04	\$5,230,000	\$4,707,000	0	0	0
Lassi Enterprises, L.L.C.	11/14/01	12/31/04	2,000,000	2,000,000	0	0	0
Glenville Town Center, Ltd.	5/1/98	12/31/04	6,500,000	<u>\$6,500,000</u>	44	11	25
Totals			<u>\$13,730,000</u>	<u>\$13,207,000</u>			

The City executed contracts between May 29, 1998 and November 14, 2001 with the three projects' administering entities. None of the contracts required the projects to create or retain jobs predominantly held by Zone residents or required the majority of the jobs created or retained by the projects to be held by Zone residents. Additionally, the City's Initiative Grant Agreement does not provide a definition for predominantly held by Zone residents. Therefore, HUD must make a determination whether the City's use of HUD funds from its Program for the three projects was appropriate.

#### **Auditee Comments**

[Excerpts paraphrased from the comments provided by the Director of the City's Department of Economic Development on our draft audit report follow. Appendix C, pages 98, 99, 103, 104, and 137 to 139, contains the complete text of the comments for this finding.]

The City believes that each of the Program projects has individually and collectively provided substantial benefits to Zone residents.

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24 CFR Part 570.209(b)(3) states an activity will be considered by HUD to provide insufficient public benefit and may under no circumstances be assisted with HUD funds when the amount of HUD assistance exceeds \$50,000 per full-time equivalent permanent job created or retained or \$1,000 per low- and moderate-income person which goods or services are provided by the activity. The projects met the public benefit criteria for goods or services to low- and moderate-income persons.

The Quincy Place and Glenville Town Center, Ltd. projects satisfied the public benefit criteria based on the provision of goods and services. The Lassi Enterprises, L.L.C. project has not been placed in productive service. Therefore, the City requests the Office of Inspector General removes its recommendations from the finding.

The City will implement steps to more fully assure: an efficient and effective Program; subrecipients use HUD funds appropriately and to benefit the Zone; the Zone complies with all applicable laws and regulations; and resources are properly safeguarded.

# OIG Evaluation Of Auditee Comments

The City provided HUD monies for its Program to fund three projects that have not provided benefits to Zone residents or benefited only 25 percent of Zone residents as of November 2002. We believe the City's use of HUD funds from its Zone Program for the Quincy Place and Glenville Town Center, Ltd. projects does not meet its Initiative Grant Agreement requiring that jobs created or retained by projects funded as Section 108 Business Loans will be predominantly held by Zone residents. We believe the City's use of HUD funds from its Zone Program for the Lassi Enterprises, L.L.C. project does not meet its Initiative Grant Agreement requiring that a majority of the jobs created or retained by projects' funded as 108/Economic Development Initiative Acquisition and Development Loans for businesses will be Zone residents.

24 CFR Part 570.209(b)(3) states an activity will be considered by HUD to provide insufficient public benefit and may under no circumstances be assisted with HUD

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funds when the amount of HUD assistance exceeds \$50,000 per full-time equivalent permanent job created or retained.

The City's Implementation Plan for the HUD 108 Real Estate Loan Program, which includes the Quincy Place and Glenville Town Center, Ltd. projects, is contained in the City's June 30, 2001 Annual Report to HUD. It states that the baseline for the project is the revitalization of distressed urban neighborhoods by offering loan and grant incentives to Zone businesses while creating job opportunity for residents. A milestone of the Implementation Plan is the Zone will create and retain 1,500 jobs for Zone residents by providing low interest loans and grants to 250 businesses utilizing the One Stop Career Center and other labor force partners. Furthermore, one of the outputs of the Implementation Plan is to create or retain 1,500 Zone jobs from loans. The Implementation Plan does not refer to providing goods or services to individuals.

The City's Implementation Plan for the Acquisition and Development Loan Program, which includes the Lassi Enterprises, Inc. project, is contained in the City's June 30, 2002 Annual Report to HUD. One of the outputs of the Implementation Plan is to create or retain 200 Zone jobs from loans. The Implementation Plan does not refer to providing goods or services to individuals.

Furthermore, the former Acting Director for the City's Zone said on December 19, 2002 that the Quincy Place, Lassi Enterprises, Inc., and Glenville Town Center, Ltd. projects must meet the public benefit criteria for job creation and retention.

The City needs to implement procedures and controls to ensure that Zone contracts meet the City's Program requirements regarding job creation and retention to Zone residents.

The City needs to amend the contract for the Lassi Enterprises, L.L.C. project cited in this finding to include requirements regarding job creation and retention to Zone residents.

#### Recommendations

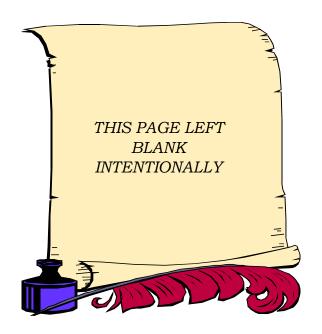
We recommend that HUD's Assistant Secretary for Community Planning and Development assure the City of Cleveland:

- 3A. Implements procedures and controls to ensure Zone contracts meet the City's Program requirements regarding job creation and retention to Zone residents.
- 3B. Amends the contract for the Lassi Enterprises, L.L.C. project cited in this finding to include requirements regarding job creation and retention to Zone residents.

We recommend that HUD's Assistant Secretary for Community Planning and Development:

3C. Ensures the three projects cited in this finding create or retain jobs predominantly held by Zone residents as required by the City's Initiative Grant Agreement. If HUD determines that the projects do not create or retain jobs predominantly held by Zone residents, then HUD should require the City to reimburse its Program the applicable amount from non-Federal funds

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## Program Income Was Not Properly Managed

The City of Cleveland did not follow its Economic Development Initiative Grant Agreement and its contract with Fairfax Renaissance Development Corporation to ensure that Empowerment Zone Program income was remitted to the City and deposited into a loan repayment account established by the City as security for the repayment of its Loan Guarantee. Fairfax Renaissance Development Corporation is fully funded with Initiative Grant funds from the City's Program and Community Development Block Grant funds. Fairfax receives fees for development services it performs. Fairfax received \$1,162,263 in development fees between 1996 and 2002. Fairfax did not remit any of the development fees to the City. The City lacked procedures and controls to ensure Program income earned by Fairfax Renaissance Development Corporation was remitted to the City and deposited into its loan repayment account. As a result, fewer funds are available to the City as security for the repayment of its Loan Guarantee.

## Federal Requirements

Paragraph 2 of the Memorandum of Agreement for the City's Program requires the City to comply with 24 CFR Part 570.

Paragraph 6 of the Economic Development Initiative Grant Agreement, effective May 17, 1996, for the City's Program states program income constitutes security for the repayment of the Section 108 Guarantee and will be deposited into a loan repayment account established by the City.

24 CFR Part 570.500(a) defines program income as gross income received by the recipient or a subrecipient directly generated from the use of HUD funds.

City's Contract With Fairfax Renaissance Development Corporation Section 4.10 of the February 7, 1996 contract between the City and Fairfax Renaissance Development Corporation states program income includes income from service fees. Section 4.10 also states project income earned during the project period will be retained by the City in accordance with the Initiative Grant Agreement.

Program Income Was Not Properly Managed

Fairfax Renaissance Development Corporation is fully funded with Initiative Grant funds from the City's Program and Community Development Block Grant funds. Fairfax receives fees for development services it performs. Fairfax received \$1,162,263 in development fees between 1996 and 2002. Fairfax did not remit any of the development fees to the City. These development fees were Program income.

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Fairfax could not provide documentation as to whether the income was generated from Initiative Grant funds or Block Grant funds.

Program income generated from development fees as a result of Fairfax Renaissance Development Corporation's use of Initiative Grant funds must be remitted to the City and deposited into its loan repayment account as required by the City's Initiative Grant Agreement with HUD and the February 7, 1996 contract between the City and Fairfax.

The City lacked procedures and controls to ensure Program income earned by Fairfax Renaissance Development Corporation was remitted to the City and deposited into its loan repayment account. As a result, fewer funds are available to the City as security for the repayment of its Loan Guarantee.

#### **Auditee Comments**

[Excerpts paraphrased from the comments provided by the Director of the City's Department of Economic Development on our draft audit report follow. Appendix C, pages 104, 105, 140, and 141, contains the complete text of the comments for this finding.]

The City's contracts with Community Development Corporations states there will be no program income in order for the Community Development Corporations to be self-sufficient when the City's Program ceases.

The definition of program income in 24 CFR Part 570.500(a)(4)(ii) excludes fees for development services.

Fairfax Renaissance Development Corporation is not fully funded with Initiative Grant and Community Development Block Grant funds. It is highly questionable that any portion of the fees for development services should be considered program income since it is possible non-Federal funds supported the activities that generated the fees for development services.

The Office of Inspector General attributes the entire amount of the fees for development services to the City's Program

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and recommends the City resolve the matter with HUD. This does not appear to meet professional standards of auditing.

The City supports Fairfax Renaissance Development Corporation retaining project fees for development services. HUD's regulations and the intent of the Program do not conflict with this treatment of fees for development services.

The City requests the Office of Inspector General removes the finding from the report.

# OIG Evaluation Of Auditee Comments

We adjusted our report to include that Section 4.10 of the February 7, 1996 contract between the City and Fairfax Renaissance Development Corporation states program income includes income from service fees. Section 4.10 also states project income earned during the project period will be retained by the City in accordance with the Initiative Grant Agreement.

Paragraph 6 of the Initiative Grant Agreement, effective May 17, 1996, for the City's Program states program income constitutes security for the repayment of the Section 108 Guarantee and will be deposited into a loan repayment account established by the City.

24 CFR 570.500(a)(4)(ii) states program income does not include amounts generated by activities that are financed by a loan guaranteed under section 108 of the Act. The Fairfax Renaissance Development Corporation Operating project was financed with Initiative Grant funds

The City provided a letter from the Executive Director of Fairfax Renaissance Development Corporation and a schedule on Fairfax Renaissance Development Corporation's analysis of annual expenses versus grant funds as of March 19, 2003 regarding the fees for development services. The City did not provide supporting documentation for the letter and schedule.

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Fairfax Renaissance Development Corporation is fully funded with Initiative Grant funds from the City's Program and Community Development Block Grant funds. Fairfax receives fees for development services it performs. Fairfax received \$1,162,263 in development fees between 1996 and 2002. Fairfax did not remit any of the development fees to the City. These development fees were program income. Fairfax could not provide documentation as to whether the program income was generated from Initiative Grant or Block Grant funds

Program income generated from development fees as a result of Fairfax Renaissance Development Corporation's use of Initiative Grant funds must be remitted to the City and deposited into a loan repayment account established by the City as required by the City's Initiative Grant Agreement with HUD and the February 7, 1996 contract between the City and Fairfax.

The City needs to provide documentation for the amount of the \$1,162,263 in program income earned with Initiative Grant funds from its Program and deposits from non-Federal funds the applicable amount of program income into its loan repayment account. If adequate documentation cannot be provided, then the City should deposit \$1,162,263 into its loan repayment account from non-Federal funds

The City needs to implement procedures and controls to ensure that program income is remitted to the City and deposited into its loan repayment account.

#### Recommendations

We recommend that HUD's Assistant Secretary for Community Planning and Development assure the City of Cleveland:

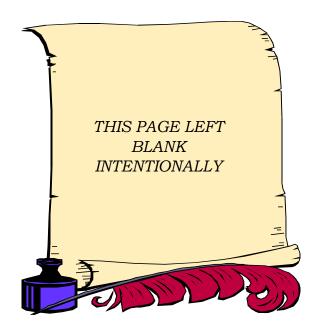
4A. Provides documentation for the amount of the \$1,162,263 in program income earned with Initiative Grant funds from its Program and deposits from non-Federal funds the applicable amount of program income into its loan repayment account. If adequate documentation cannot be provided, then the City

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- should deposit \$1,162,263 into its loan repayment account from non-Federal funds.
- 4B. Implements procedures and controls to ensure that program income is remitted to the City and deposited into a loan repayment account established by the City.

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## Management Controls

Management controls include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Management Controls We determined that the following management controls were relevant to our audit objectives:

- Program Operations Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Validity and Reliability of Data Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with Laws and Regulations Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding Resources Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed all of the relevant controls identified above during our audit of the City's Program.

It is a significant weakness if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet an organization's objectives.

Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

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## • <u>Program Operations</u>

The City inappropriately used and lacked documentation to show that HUD funds benefited its Program or were matched with in-kind services as required (see Finding 1). The City also did not ensure that Program income was remitted to the City and deposited into its loan repayment account established as security for the repayment of its Loan Guarantee (see Finding 4).

### • Validity and Reliability of Data

The City inaccurately reported the actual status and/or progress for eight of the 10 projects we reviewed from its June 30, 2001 Annual Report. The City's Report contained inaccuracies related to the eight projects' progress on projected outputs, milestones, and sources and/or uses of program funds (see Finding 2).

### • Compliance with Laws and Regulations

The City failed to follow: Office of Management and Budget Circular A-87 and 24 CFR Parts 85, 570, and 597 regarding the use of HUD funds for its Program; and HUD's regulation regarding the reporting of actual status and/or progress for eight of the 10 projects we reviewed from its June 30, 2001 Annual Report (see Findings 1 and 2).

## • Safeguarding Resources

The City: inappropriately used \$6,891,245 of HUD funds that did not benefit the City's Program or were not matched with in-kind contributions; lacked documentation to support that another \$4,744,824 in HUD funds paid benefited the City's Program; and failed to ensure that Program income was remitted to the City and deposited into its loan repayment account established as security for the repayment of its Loan Guarantee (see Findings 1 and 4).

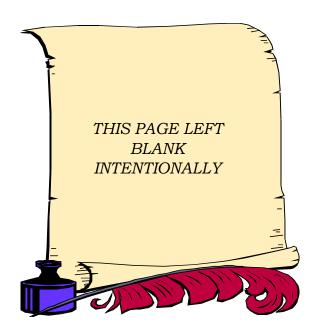
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## Follow Up On Prior Audits

This is the first audit of the City of Cleveland, Ohio's Program by HUD's Office of Inspector General. The Office of Inspector General issued an audit report on Hough Area Partners in Progress, Inc. on September 24, 1997 pertaining to its use of Community Development Block Grant and HUD funds from the City's Program (Audit Case Number 97-CH-241-1011). The report contained two findings. Neither of the two findings involved HUD funds from the City's Program. The latest Single Audit Report for the City covered the period ending December 31, 2001. The Report contained 19 findings. Two of the findings involved HUD funds from the City's Program. One of the two findings is reported in this report.

Independent Auditor's Report	This Report
Empowerment Zone Community Development Centers	Controls Over HUD Funds Were Not Adequate

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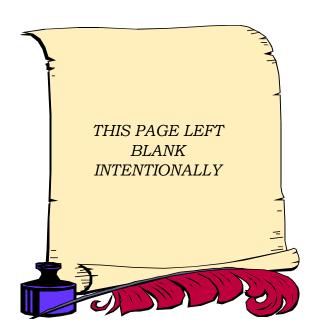


## Schedule Of Questioned Costs

Recommendation	Type of Questioned Costs		
<u>Number</u>	Ineligible 1/	Unsupported 2/	
1A	\$6,891,245		
1B	,	\$4,744,824	
4A		1,162,263	
Total	\$6,891,245	\$5,907,087	

- <u>1/</u> Ineligible costs are costs charged to a HUD-financed or insured program or activity that the auditor believes are not allowable by law, contract, or Federal, State, or local policies or regulations.
- Unsupported costs are costs charged to a HUD-financed or insured program or activity and eligibility cannot be determined at the time of the audit. The costs are not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the cost. Unsupported costs require a future decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.

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## Projects Reviewed

This appendix contains the individual evaluations for the projects we reviewed. We selected 10 of the City's 88 projects reported in its June 30, 2001 Annual Report. We found that the City inappropriately used HUD funds for 10 projects, inaccurately reported the accomplishments of its Program to HUD for eight projects, did not provide adequate public benefit for three projects, and failed to require the repayment of Program income for one project. The following table shows all 10 of the projects that had problems, the location of their evaluation in this appendix, and the finding(s) they relate to.

Project	Page	Finding
Glenville Town Center, Ltd.	44	1 and 2
Quincy Place	49	1 and 2
Midtown Corporate Center	59	1 and 2
Lassi Enterprises, L.L.C.	66	1
<b>Empowerment Zone Commercial Security</b>	71	1
Fairfax Renaissance Development Corporation Operating	74	1, 2, and 4
Center for Employment and Training – Cleveland, Inc.	80	1 and 2
Vocational Guidance Services' Job Match	84	1 and 2
IMR Global - Orion Consulting, Inc. And The Network Bank	90	1 and 2
Teller Job Training		
Hough Area Partners In Progress Operating	94	1 and 2

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# Controls Over Glenville Town Center, Ltd. Project Were Not Adequate

The City did not maintain adequate controls over the Glenville Town Center, Ltd. project. Glenville Town Center, Ltd. inappropriately used \$6,121 of Loan Guarantee funds from the City's Program. The City also inaccurately reported the actual progress of the project in its June 30, 2001 Annual Report. The City lacked adequate documentation to support the outputs, milestones, and sources of project funds from non-Zone grants. The problems occurred because the City lacked effective oversight and controls to assure that HUD funds for its Zone Program were used appropriately and accurate information was included in the City's June 2001 Annual Report. As a result, HUD funds for the City's Zone Program were not used efficiently and effectively. The City also did not provide HUD with an accurate representation of the project.

The City Lacked Adequate Controls Over Zone Funds

The City lacked adequate oversight of the Glenville Town Center, Ltd. project. The City executed a Loan Agreement on May 29, 1998 with Glenville Town Center, Ltd. for \$2,000,000 in Loan Guarantee funds from the City's Program to provide economic development assistance by assisting in the acquisition and development of property at the intersection of St. Clair Avenue and East 105<sup>th</sup> Street in Cleveland, Ohio. The City and the Center amended the Loan Agreement on May 21, 1999 to increase the loan to \$5,000,000 and include \$1,500,000 in Initiative Grant funds. The City provided \$6,500,000 in HUD funds from its Zone Program for the project. As of February 2003, Glenville Town Center, Ltd. made payments reducing the principal of the loan by \$195,044.

Glenville Town Center, Ltd. inappropriately used \$6,121 of HUD Loan Guarantee funds from the City's Zone Program to pay for entertainment expenses. The expenses included \$3,053 for the catering of a topping off ceremony, \$2,500 for the catering of a groundbreaking ceremony, and \$568 for miscellaneous entertainment expenses. Office of Management and Budget Circular A-87, Attachment B (18), states costs of entertainment, including meals associated with social activities, are unallowable.

The City's Assistant Controller approved the payments for expenses if an administering entity provided an invoice or a document supporting the amount requested. She did not The City Could Not Provide Documentation That It Performed A Public Benefit Analysis For The Project review whether the expenses met Federal requirements. As a result, HUD Loan Guarantee funds for the City's Zone Program were not used efficiently and effectively.

The City lacked documentation to support that it performed an analysis to determine that a minimum level of public benefit would be achieved by the Glenville Town Center, Ltd. project. Specifically, the City did not determine whether the project's assistance would exceed \$50,000 per full-time equivalent, permanent job created or retained. Therefore, the City was required to show that the project would create or retain at least 40 (\$2,000,000 divided by \$50,000) jobs. When the City amended the contract to increase the amount of HUD funds from its Program for the project to \$6,500,000, the City was required to show that the project would create or retain at least 130 (\$6,500,000 divided by \$50,000) jobs.

As of November 2002, documentation maintained by the City and Glenville Town Center, Ltd. showed that only 44 jobs were created or retained. The former Acting Director of the City's Zone said the Glenville Town Center, Ltd. project has until December 31, 2004 to achieve the job creation and retention standard. However, the Glenville Development Corporation's Executive Director said it is estimated that only 80 full and part-time jobs will be created as a result of the project.

The City could not provide an explanation as to why it could not provide supporting documentation for the public benefit determination of the Glenville Town Center, Ltd. project. As a result, the City lacks assurance that HUD funds for the City's Program were used efficiently and effectively.

The City Inaccurately Reported The Project's Accomplishments The City incorrectly reported in its June 30, 2001 Annual Report the actual progress of the Glenville Town Center, Ltd. project. The City reported the accomplishments for the project under the HUD 108 Real Estate Loan Program Implementation Plan. The Plan included the accomplishments for all of the City's HUD 108 Real Estate Loan Program projects. The City lacked adequate documentation to support the outputs, milestones, and sources of project funds from non-Zone grants reported under the HUD 108 Real Estate Loan Program.

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For example, the City reported for an output in its June 30, 2001 Annual Report that 1,097 Zone resident jobs were created or retained by its HUD 108 Real Estate Loan Program projects. The City provided a schedule for the Zone resident jobs created or retained without supporting documentation. The schedule showed that 1,577 and 80 Zone resident jobs were created or retained from projects in its HUD 108 Real Estate Loan Program and by the Glenville Town Center, Ltd. project, respectively. Documentation maintained by the City and Glenville Town Center, Ltd. showed that no Zone resident jobs were created or retained as of June 30, 2001.

The former Director of the City's Zone said HUD directed them to report the HUD 108 Real Estate Loan Program projects in one Implementation Plan. The former Director could not provide documentation to support this statement. A Community Planning and Development Specialist in HUD's Renewal Communities/Empowerment Zones/Enterprise Communities Initiative said a Zone is to report each project in its own Implementation Plan. Furthermore, page 2 of the Empowerment Zone and Enterprise Community Initiative Performance Measurement System guidance issued in April 2001 states Zones are required to create an Implementation Plan for each project undertaken

The City could not provide supporting documentation for the schedule showing the number of Zone jobs created or retained. As a result, the City did not accurately report the accomplishments of its Program to HUD.

#### **Auditee Comments**

[Excerpts paraphrased from the comments provided by the Director of the City's Department of Economic Development on our draft audit report follow. Appendix C, pages 100 to 104, 110, 126 to 128, 130, 131, 133, 134, and 137 to 139, contains the complete text of the comments for this finding.]

Glenville Town Center, Ltd. did not inappropriately use \$6,121 of Loan Guarantee funds from the City's Zone Program to pay for entertainment expenses. The event was organized to promote the imminent opening of a new

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community service facility for Zone residents. The event is allowable under Office of Management and Budget Circular A-87, Attachment B, paragraph 2.

The City adequately planned for the Glenville Town Center project. The project achieved the mandatory public benefit criteria established by 24 CFR Part 570.

24 CFR Part 570.209(b)(3) states an activity will be considered by HUD to provide insufficient public benefit and may under no circumstances be assisted with HUD funds when the amount of HUD assistance exceeds \$50,000 per full-time equivalent permanent job created or retained or \$1,000 per low and moderate-income person which goods or services are provided by the activity. The projects met the public benefit criteria for goods or services to low and moderate-income persons.

Glenville Town Center, Ltd. did not lack adequate documentation to support that \$80,822 of Loan Guarantee funds from the City's Zone Program was used to pay Glenville Development Corporation for development fees. The City paid the development fee to Glenville Town Center, Ltd. Glenville Town Center, Ltd. then paid The Coral Company and Glenville Development Corporation.

# OIG Evaluation Of Auditee Comments

The City did not provide documentation that the catering of a topping off ceremony, the catering of a groundbreaking ceremony, and miscellaneous entertainment expenses were either advertising or public relations expenses. Therefore, Glenville Town Center, Ltd. inappropriately used \$6,121 of Loan Guarantee funds from the City's Zone Program to pay for entertainment expenses.

24 CFR Part 570.209(b)(3) states an activity will be considered by HUD to provide insufficient public benefit and may under no circumstances be assisted with HUD funds when the amount of HUD assistance exceeds \$50,000 per full-time equivalent permanent job created or retained.

The City's Implementation Plan for the HUD 108 Real Estate Loan Program, which includes the Glenville Town

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Center, Ltd. project, is contained in the City's June 30, 2001 Annual Report to HUD. It states the baseline for the program is the revitalization of distressed urban neighborhoods by offering loan and grant incentives to Zone businesses while creating job opportunity for residents. A milestone of the Implementation Plan is the Zone will create and retain 1,500 jobs for Zone residents by providing low interest loans and grants to 250 businesses utilizing the One Stop Career Center and other labor force partners. Furthermore, one of the outputs of the Implementation Plan is to create or retain 1,500 Zone jobs from loans. The Implementation Plan does not refer to providing goods or services to individuals.

Furthermore, the former Acting Director for the City's Zone said on December 19, 2002 that the Glenville Town Center, Ltd. project must meet the public benefit criteria for job creation and retention.

The City lacked documentation to support that it performed an analysis to determine that a minimum level of public benefit would be achieved by the Glenville Town Center, Ltd. project as required by 24 CFR Part 570.209(b). Specifically, the City did not determine whether the project's assistance would exceed \$50,000 per full-time equivalent, permanent job created or retained. Therefore, the City was required to show that the project would create or retain at least 40 (\$2,000,000 divided by \$50,000) jobs. When the City amended the contract to increase the amount of HUD funds for the project to \$6,500,000, the City was required to show that the project would create or retain at least 130 (\$6,500,000 divided by \$50,000) jobs.

We adjusted our audit report by removing that the Glenville Town Center, Ltd. lacked adequate documentation to support that \$80,822 of Loan Guarantee funds from the City's Zone Program was used to pay Glenville Development Corporation for development fees.

# Controls Over Quincy Place Project Were Not Adequate

The City did not maintain adequate controls over the Quincy Place project. The City inappropriately used \$3,677,000 in Section 108 Loan funds for its Program when it entered into a March 19, 2001 Loan and Grant Agreement with Fairfax Renaissance Development Corporation, the administering entity of the Quincy Place project. Furthermore, Fairfax Renaissance Development Corporation inappropriately used \$1,309,367 of HUD funds (\$1,021,029 in Section 108 Loan funds and \$288,338 in Initiative Grant funds) that did not benefit the City's Zone Program. The City also inaccurately reported the actual progress of the project in its June 30, 2001 Annual Report. The City lacked adequate documentation to support the outputs, milestones, and sources of project funds from non-Zone grants. The problems occurred because the City lacked effective oversight and controls to assure that HUD funds for its Zone Program were used appropriately and that accurate information was included in the City's June 2001 Annual Report. As a result, HUD funds for the City's Zone Program were not used efficiently and effectively. The City also did not provide HUD with an accurate representation of the project.

The City Lacked Adequate Controls Over Zone Funds

The City lacked adequate oversight of the Quincy Place project. The City executed a Loan and Grant Agreement on March 19, 2001 with Fairfax Renaissance Development Corporation, the administering entity for the Quincy Place project, to provide rental office space in the Zone. The Agreement totaled \$5,230,000 in HUD funds (\$4,200,000 in Section 108 Loan funds and \$1,030,000 in Initiative Grant funds) from the City's Program. The City provided \$4,707,000 in HUD funds (\$3,677,000 in Loan Guarantee funds and \$1,030,000 in Initiative Grant funds) from its Zone Program for the project. Fairfax also submitted a voucher package for the remaining \$523,000 of Loan Guarantee funds for the project. The City had not disbursed these funds as of February 4, 2003. The Controller for the City's Zone said the City is withholding the \$523,000 until the Office of Inspector General's audit is completed.

The City inappropriately used the \$3,677,000 of Loan Guarantee funds for its Zone Program when it entered into the Loan and Grant Agreement with Fairfax Renaissance Development Corporation, a non-profit corporation, for the Quincy Place project. The project is categorized as a Section 108 Business Loan. The City's Supplemental Zone HUD

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108 Loan Guarantee Program Application dated April 26, 1995 to HUD did not allow non-profit corporations to be funded under a Section 108 Business Loan.

Furthermore, Fairfax Renaissance Development Corporation inappropriately used HUD funds from the City's Zone Program to purchase land and build an office building to provide rental office space in the Zone. Fairfax maintains its offices in 11 percent of the building and the County of Cuyahoga rents the remaining 89 percent of the office building's space for its Family Service Center. The County's Family Service Center maintains 154 employees in the Quincy Place project. Forty-eight (31.2 percent) of the employees relocated from outside the Zone. The City entered into the contract for the Quincy Place project with the knowledge that the County's Family Service Center was going to relocate employees from outside the Zone to the Zone. Therefore, Fairfax inappropriately used \$1,307,039 (31.2 percent of \$4,707,000 times 89 percent) of HUD funds (\$1,021,029 in Section 108 Loan funds and \$286,010 in Initiative Grant funds) from the City's Zone Program.

Fairfax Renaissance Development Corporation also inappropriately used \$2,328 of Initiative Grant funds from the City's Zone Program to pay for entertainment expenses. The expenses included \$1,155 for the catering of a topping off ceremony and \$1,173 for the catering of a groundbreaking ceremony. Office of Management and Budget Circular A-87, Attachment B (18), states the costs of entertainment, including meals associated with social activities, are unallowable.

The Senior Business Development Specialist of the City's Zone said the City was not aware its application to HUD did not allow non-profit entities to be funded as Section 108 Business Loans. The former Acting Director of the City's Zone was not aware of the relocation requirement contained at 24 CFR Part 597.200(e). After he reviewed the requirement, he did not believe the relocation of the County of Cuyahoga's Family Service Center and the County's 48 jobs violated the relocation requirement. However, the former Acting Director could not provide support for his opinion. The City's Assistant Controller approved the payments for expenses if the administering entity provided an invoice or a document supporting the amount requested.

The City Could Not Provide Documentation That It Performed A Public Benefit Analysis For The Project She did not review whether the expenses met Federal requirements. As a result, HUD funds for the City's Zone Program were not used efficiently and effectively.

The City lacked documentation to support that it performed an analysis to determine that a minimum level of public benefit would be achieved by the Quincy Place project. Specifically, the City did not determine whether the project's assistance would exceed \$50,000 per full-time equivalent, permanent job created or retained. Therefore, the City was required to show that the project would create or retain at least 105 (\$5,230,000 divided by \$50,000) jobs.

As of December 2002, documentation maintained by the City and Fairfax Renaissance Development Corporation showed that no jobs were created or retained. The former Acting Director of the City's Zone said the Quincy Place project has until December 31, 2004 to achieve the job creation and retention standard.

The City could not provide an explanation as to why it could not provide supporting documentation for the public benefit determination of the Quincy Place project. As a result, HUD lacks assurance that the City's Program funds were used efficiently and effectively.

The City incorrectly reported in its June 30, 2001 Annual Report the actual progress of the Quincy Place project. The City reported the accomplishments for the project under the HUD 108 Real Estate Loan Program Implementation Plan. The Plan included the accomplishments for all of the City's HUD 108 Real Estate Loan Program projects. The City did not have adequate documentation to support the outputs, milestones, and sources of project funds from non-Zone grants reported under the HUD 108 Real Estate Loan Program.

For example, the City reported in its June 30, 2001 Annual Report for an output that 1,097 Zone resident jobs were created or retained by its HUD 108 Real Estate Loan Program projects. The City provided a schedule for the Zone resident jobs created or retained without supporting documentation. The schedule showed that 1,577 and 171 Zone resident jobs were created or retained from projects in

The City Inaccurately Reported The Project's Accomplishments

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its HUD 108 Real Estate Loan Program and by the Quincy Place project, respectively. Documentation maintained by the City and Fairfax Renaissance Development Corporation showed that no Zone resident jobs were created or retained as of June 30, 2001.

The former Director of the City's Zone said HUD directed them to report the HUD 108 Real Estate Loan Program projects in one Implementation Plan. The former Director could not provide documentation to support this statement. A Community Planning and Development Specialist in HUD's Renewal Communities/Zones/Enterprise Communities Initiative said a Zone is to report each project in its own Implementation Plan. Furthermore, page 2 of the Empowerment Zone and Enterprise Community Initiative Performance Measurement System guidance issued in April 2001 states Zones are required to create an Implementation Plan for each project undertaken.

The City could not provide supporting documentation for the schedule showing the number of Zone jobs created or retained. As a result, the City did not accurately report the accomplishments of their Program to HUD.

#### **Auditee Comments**

[Excerpts paraphrased from the comments provided by the Director of the City's Department of Economic Development on our draft audit report follow. Appendix C, pages 99 to 104, 108 to 110, 112 to 115, 127 to 129, and 137 to 139, contains the complete text of the comments for this finding.]

The City's Supplemental Empowerment Zone HUD 108 Loan Guarantee Program Application dated April 26, 1995, the City's June 5, 1996 Contract For Loan Guarantee Assistance, and Federal regulations allow Loan Guarantee funds to be used for community development and by non-profit entities. The City's Loan Application does not specifically state projects funded as Section 108 Business Loans must be for-profit entities. Part II, paragraph 15(a), of the Contract for Loan Assistance states guaranteed loan funds will be used by the borrower to assist for-profit businesses, community-based development organizations, and non-profit organizations as sub-recipients in carrying

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out economic development activities and projects as authorized under 24 CFR Part 570.703(i).

The Office of Inspector General incorrectly used a requirement that does not exist in the City's Loan Application and Contract For Loan Assistance. Part II(C)(2) of the application states to be eligible as an Acquisition and Development Revolving Loan, borrowers must show a record of profitability or, in the case of non-profit organizations, an ability to successfully manage fiduciary responsibilities.

The Office of Inspector General inappropriately only uses 24 CFR Part 570.203(b) in its evaluation of the Quincy Place project. 24 CFR Part 570.703(i)(1) states that Loan Guarantee funds may be used for economic development activities eligible under 24 CFR Part 570.203. The Office of Inspector General failed to include 24 CFR Part 570.203(a) in its analysis of the project. 24 CFR Part 570.203(a) states a recipient may use Loan Guarantee funds for special economic development activities carried out by non-profit subrecipients.

The language contained in the Federal requirements and the City's Contract for Loan Assistance support the City making loans to non-profit entities. Therefore, it appears the Office of Inspector General misinterpreted the City's ability to loan monies to non-profits.

The City believes Fairfax Renaissance Development Corporation, the administering entity for the Quincy Place project, appropriately used HUD funds from the City's Program to purchase land and build an office building to provide rental office space in the Zone. The Office of Inspector General's concern is that the project reduced the County of Cuyahoga's employment outside the Zone when the County relocated its Family Service Center to the Quincy Place project.

The Office of Inspector General admitted that it never conducted an employment analysis to determine whether the County's employment outside the Zone decreased as result of the relocation of the County's Family Service Center. The Office of Inspector General did not

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demonstrate that the relocation of the Family Service Center reduced the County's employment at the original location or outside the Zone.

24 CFR Part 597 is not applicable to the City's Program. Therefore, the Office of Inspector General inappropriately applied the requirements of 24 CFR Part 597.200(e) to the Quincy Place project.

Fairfax Renaissance Development Corporation did not inappropriately use \$2,328 of Initiative Grant funds from the City's Zone Program to pay for entertainment expenses for catering of a topping off ceremony and groundbreaking ceremony. The events were organized to promote the opening of a new community service facility for Zone residents. The events are allowable under Office of Management and Budget Circular A-87, Attachment B, paragraph 2. Therefore, the Office of Inspector General incorrectly applied Attachment B, paragraph 18, of the Circular.

The City adequately planned for the Quincy Place project. The project achieved the mandatory public benefit criteria established by 24 CFR Part 570.

24 CFR Part 570.209(b)(3) states an activity will be considered by HUD to provide insufficient public benefit and may under no circumstances be assisted with HUD funds when the amount of HUD assistance exceeds \$50,000 per full-time equivalent permanent job created or retained or \$1,000 per low and moderate-income person which goods or services are provided by the activity. The projects met the public benefit criteria for goods or services to low and moderate-income persons.

The City communicated with HUD regarding the Quincy Place project. HUD never informed the City that the project was prohibited.

## OIG Evaluation Of Auditee Comments

We agree that the City's Supplemental Empowerment Zone HUD 108 Loan Guarantee Program Application, the City's June 5, 1996 Contract For Loan Guarantee Assistance, and Federal regulations allow Loan Guarantee funds to be used

for community development and by non-profit entities. We also agree that Part II, paragraph 15(a), of the Contract for Loan Assistance states guaranteed loan funds will be used by the borrower to assist for-profit businesses, community-based development organizations, and non-profit organizations as subrecipients in carrying out economic development activities and projects as authorized under 24 CFR Part 570.703(i).

We mistakenly used a document that the former Acting Director of the City's Zone said was part of the City's application to HUD for the Program. We only used 24 CFR Part 570.203(b), because the document provide by the former Acting Director stated projects funded as Section 108 Business Loans must be eligible under 24 CFR Part 570.203(b) as direct assistance to for-profit entities.

Therefore, we adjusted our report by including the City's application to HUD for the Program states projects funded as Section 108 Business Loans must be eligible under 24 CFR Part 570.203(b) as direct assistance to for-profit entities and included Part II(C)(1) and (2) of the City's Supplemental Empowerment Zone HUD 108 Loan Guarantee Program Application dated April 26, 1995 to HUD for the Program. Part II(C)(1) of the City's Loan Application states to be eligible as a Section 108 Business Loan, companies must show a record of profitability. Part II(C)(2) of the application states to be eligible as an Acquisition and Development Revolving Loan, borrowers must show a record of profitability or, in the case of nonprofit organizations, an ability to successfully manage fiduciary responsibilities. Therefore, since the City did not include that a non-profit organization was eligible for a Section 108 Business Loan like it did for an Acquisition and Development Revolving Loan, non-profit corporations are not eligible for a Section 108 Business Loan.

We adjusted our audit report by removing that the City inappropriately used \$1,030,000 in Initiative Grant funds for its Program when it entered into a loan and grant agreement with Fairfax Renaissance Development Corporation, a non-profit corporation, for the Quincy Place project. Therefore, the City inappropriately used

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\$3,677,000 in Loan Guarantee funds for its Zone Program when it entered into the loan and grant agreement.

Fairfax Renaissance Development Corporation, the administering entity for the Quincy Place project, inappropriately used HUD funds from the City's Program to purchase land and build an office building to provide rental office space in the Zone.

We adjusted our audit report to state that 48 (31.2 percent) of the employees relocated from the office at 1641 Payne Avenue, which is outside the Zone. The Interim Center Manager for the County's Employment and Family Services in Fairfax said the 48 employees were not replaced at the office located at 1641 Payne Avenue.

We stated in our exit conference with the City that we never conducted employment analysis to determine whether the County's total employment outside the Zone decreased as a result of the relocation of the County's Family Service The Interim Center Manager for the County's Employment and Family Services in Fairfax said the 48 employees were not replaced at the office located at 1641 Payne Avenue. 24 CFR Part 597.200(e) states the Strategic Plan may not include any action to assist an establishment in relocating from outside the nominated urban area to the nominated urban area unless the assistance is for the establishment of a new branch, affiliate, or subsidiary that will not result in a decrease of the establishment's employment in the area of original location or in any area where the existing entity conducts business operations and there is not reason to believe the new branch, affiliate, or subsidiary is being established with the intention of closing down the operations of the existing entity in the area of its original location or in any other area where the existing entity conducts business operations. Therefore, we were not required to determine whether the County's total employment outside the Zone decreased as a result of the relocation of the County's Family Service Center.

Paragraph 1 of the Memorandum of Agreement for the City's Program requires the City to comply with 24 CFR Part 597. Therefore, we appropriately applied the requirements of 24 CFR Part 597.200(e) to the Quincy Place project.

The City did not provide documentation that the catering of a topping off ceremony and groundbreaking ceremony were either advertising or public relations expenses. Therefore, Fairfax Renaissance Development Corporation inappropriately used \$2,328 of Initiative Grant funds from the City's Zone Program to pay for entertainment expenses for the catering of a topping off ceremony and groundbreaking ceremony.

24 CFR Part 570.209(b)(3) states an activity will be considered by HUD to provide insufficient public benefit and may under no circumstances be assisted with HUD funds when the amount of HUD assistance exceeds \$50,000 per full-time equivalent permanent job created or retained.

The City did not provide any documentation that it provided HUD an analysis of how the Quincy Place project would provide sufficient public benefit.

The City's Implementation Plan for the HUD 108 Real Estate Loan Program, which includes the Quincy Place project, is contained in the City's June 30, 2001 Annual Report to HUD. It states the baseline for the program is the revitalization of distressed urban neighborhoods by offering loan and grant incentives to Zone businesses while creating job opportunity for residents. A milestone of the Implementation Plan is that the Zone will create and retain 1,500 jobs for Zone residents by providing low interest loans and grants to 250 businesses utilizing the One Stop Career Center and other labor force partners. Furthermore, one of the outputs of the Implementation Plan is to create or retain 1,500 Zone jobs from loans. The Implementation Plan does not refer to providing goods or services to individuals

Furthermore, the former Acting Director for the City's Zone said on December 19, 2002 that the Quincy Place project must meet the public benefit criteria for job creation and retention.

The City lacked documentation to support that it performed an analysis to determine that a minimum level of public benefit would be achieved by the Quincy Place project as required by 24 CFR Part 570.209(b). Specifically, the City

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did not determine whether the project's assistance would exceed \$50,000 per full-time equivalent, permanent job created or retained. Therefore, the City was required to show that the project would create or retain at least 105 (\$5,230,000 divided by \$50,000) jobs.

# Controls Over Midtown Corporate Center Project Were Not Adequate

The City did not maintain adequate controls over the Midtown Corporate Center project. Midtown Associates, L.L.C., the administering entity for the project, inappropriately used \$277,567 of Loan Guarantee funds that did not benefit the City's Program. The City lacked documentation to support the selection of the project for funding and Midtown subsequently used \$2,754,996 of Loan Guarantee funds from the City's Zone Program without creating or retaining jobs. The City also inaccurately reported the actual progress of the project in its June 30, 2001 Annual Report. The City did not have adequate documentation to support the outputs, milestones, and sources of project funds from non-Zone grants. The problems occurred because the City lacked effective oversight and controls to assure that Loan Guarantee funds for its Zone Program were used appropriately and accurate information was included in the City's June 2001 Annual Report. As a result, Loan Guarantee funds for the City's Zone Program were not used efficiently and effectively. The City also did not provide HUD with an accurate representation of the project.

The City Lacked Adequate Controls Over Zone Funds

The City lacked adequate oversight of the Midtown Corporate Center project. The City executed a Loan Agreement on June 30, 1998 with Midtown Associates, L.L.C., the administering entity for the Midtown Corporate Center project, to provide rental office space in the Zone. The City provided \$3,000,000 in Section 108 Loan funds from its Program for the project. As of February 2003, Midtown Associates, L.L.C. made payments reducing the principal of the loan by \$47,164.

Midtown Associates, L.L.C. inappropriately used Loan Guarantee funds from the City's Zone Program to purchase an existing office building and build a new office building to provide rental office space in the Zone. As of February 2003, four tenants rent 42,000 square feet of the 58,500 square feet of office space in the two buildings. One of the tenants, the City's Zone office, relocated to the Zone from outside the Zone. The City's Zone office rents 9.4 percent of the two office buildings' space. Midtown Associates, L.L.C. has not rented 16,500 square feet of the office space. Documentation maintained by the City and Midtown Associates, Inc. did not show that the City's Zone office created or retained jobs. Therefore, Midtown Associates,

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L.L.C. inappropriately used \$277,567 (9.4 percent of \$3,000,000 minus \$47,164) of Loan Guarantee funds from the City's Zone Program.

The former Acting Director of the City's Zone was not aware of the relocation requirement contained at 24 CFR Part 597.200(e). After he reviewed the requirement, he did not believe the relocation of the City's Zone violated the relocation requirement. However, the former Acting Director could not provide support for his opinion. As a result, Loan Guarantee funds for the City Program were not used efficiently and effectively.

The City Could Not Provide Documentation That It Performed A Public Benefit Analysis For The Project The City lacked documentation to support that it performed an analysis to determine that a minimum level of public benefit would be achieved by the Midtown Corporate Center project. Specifically, the City did not determine whether the project's assistance would exceed \$50,000 per full-time equivalent, permanent job created or retained. Therefore, the City was required to show that the project would create or retain at least 60 (\$3,000,000 divided by \$50,000) jobs.

The June 30, 1998 Agreement between the City and Midtown Associates, L.L.C. required Midtown to achieve the job creation and retention requirements by June 30, 2001. As of October 2002, documentation maintained by the City and Midtown Associates, L.L.C. showed that only four of the 60 jobs (6.7 percent) were created or retained. Therefore, Midtown used \$2,754,996 (93.3 percent of \$3,000,000 minus \$47,164) of Loan Guarantee funds from the City's Program without creating or retaining jobs. The former Acting Director of the City's Zone said the job creation standard was too difficult for the Midtown Corporate Center project to meet because the employees who work in the office buildings usually need special training or college degrees.

The City could not provide an explanation as to why it could not provide supporting documentation for the public benefit determination of the Midtown Corporate Center project. As a result, HUD lacks assurance that Loan Guarantee funds for the City's Zone Program were used efficiently and effectively.

The City Inaccurately Reported The Project's Accomplishments The City incorrectly reported in its June 30, 2001 Annual Report the actual progress of the Midtown Corporate Center project. The City reported the accomplishments for the project under the HUD 108 Real Estate Loan Program Implementation Plan. The Plan included the accomplishments for all of the City's HUD 108 Real Estate Loan Program projects. The City did not have adequate documentation to support the outputs, milestones, and sources of project funds from non-Zone Grants reported under the HUD 108 Real Estate Loan Program.

For example, the City reported in its June 30, 2001 Annual Report for an output that 1,097 Zone resident jobs were created or retained by its HUD 108 Real Estate Loan Program projects. The City provided a schedule for the Zone resident jobs created or retained without supporting documentation. The schedule showed that 1,577 and 122 Zone resident jobs were created or retained from projects in its HUD 108 Real Estate Loan Program and by the Midtown Corporate Center project, respectively. Documentation maintained by the City and Midtown Associates, L.L.C. showed that only one Zone resident job was created or retained as of June 30, 2001.

The former Director of the City's Zone said HUD directed them to report the HUD 108 Real Estate Loan Program projects in one Implementation Plan. The former Director could not provide documentation to support this statement. A Community Planning and Development Specialist in HUD's Renewal Communities/Empowerment Zones/Enterprise Communities Initiative said a Zone is to report each project in its own Implementation Plan. Furthermore, page 2 of the Empowerment Zone and Enterprise Community Initiative Performance Measurement System guidance issued in April 2001 states Zones are required to create an Implementation Plan for each project undertaken.

The City could not provide supporting documentation for the schedule showing the number of Zone jobs created or retained. As a result, the City did not accurately report the accomplishments of its Program to HUD.

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#### **Auditee Comments**

[Excerpts paraphrased from the comments provided by the Director of the City's Department of Economic Development on our draft audit report follow. Appendix C, pages 99 to 101, 108 to 110, 115 to 117, and 127 to 129, contains the complete text of the comments for this finding.]

The City believes Midtown Associates, L.L.C., the administering entity of the Midtown Corporate Center project, appropriately used Loan Guarantee funds from the City's Zone Program to purchase an existing office building and build a new office building to provide rental office space in the Zone.

The Office of Inspector General inappropriately applied the requirements of 24 CFR Part 597.200(e) to the Midtown Corporate Center project.

The City's relocation of its Zone offices to the Midtown Corporate Center did not result in a decrease in employment for the City or the closing down of an existing City operation.

The Office of Inspector General admitted that it never conducted an employment analysis to determine whether the relocation of the City's Zone offices resulted in a decrease in employment for the City. The City provided documentation supporting that the relocation did not decrease employment for the City.

The City's Zone offices were moved during the Office of Inspector General's audit. The Office of Inspector General never cautioned the City that the move violated 24 CFR Part 570.200(e).

The relocation of City Architecture from 3311 Perkins Avenue to Midtown Corporate Center did not violate 24 CFR 597.200(e). City Architecture's offices were located in the Buffer Zone for the City's Program. HUD granted the City to extend approved economic development lending activities eligible under 24 CFR Part 570.703(I)(1) to the Buffer Zone. Businesses located in the Buffer Zone are

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eligible to receive all the benefits allowable within the original Zone.

The Midtown Corporate Center project retained and created 63 and 10 jobs, respectively.

The City adequately planned for the Midtown Corporate Center project. The project achieved the mandatory public benefit criteria established by 24 CFR Part 570.

24 CFR Part 570.209(b)(3) states an activity will be considered by HUD to provide insufficient public benefit and may under no circumstances be assisted with HUD funds when the amount of HUD assistance exceeds \$50,000 per full-time equivalent permanent job created or retained or \$1,000 per low- and moderate-income person which goods or services are provided by the activity. The projects met the public benefit criteria for goods or services to low- and moderate-income persons.

## OIG Evaluation Of Auditee Comments

Paragraph 1 of the Memorandum of Agreement for the City's Program requires the City to comply with 24 CFR Part 597. Therefore, we appropriately applied the requirements of 24 CFR Part 597.200(e) to the Midtown Corporate Center project.

The City failed to provide documentation that the relocation of its Zone offices to the Midtown Corporate Center did not result in a decrease in employment for the City in the original location or in any other area where the City conducts operations.

We did not say we never conducted an employment analysis to determine whether the relocation of the City's Zone offices resulted in a decrease in employment for the City.

We did not review the Midtown Corporate Center project until after the City moved its Zone offices. Also, the City never asked us whether the move violated 24 CFR Part 570.200(e). Furthermore, we are not program

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administrators with the authority to provide guidance on HUD requirements.

We adjusted our audit report by reducing the number of tenants that relocated to the Zone from outside the Zone, the percent of the two office buildings' space occupied by the tenants by 20.2 percent, and the amount of Loan Guarantee funds Midtown Associates, L.L.C. inappropriately used by \$596,472. Therefore, Midtown Associates, L.L.C. inappropriately used \$277,567 of Loan Guarantee funds from the City's Program.

The City provided schedules for creation and retention of jobs by the Midtown Corporate Center project. The City did not provide the supporting documentation for the schedules. Therefore, documentation maintained by Midtown Associates, L.L.C. did not show that the City's Zone office created or retained jobs.

24 CFR Part 570.209(b)(3) states an activity will be considered by HUD to provide insufficient public benefit and may under no circumstances be assisted with HUD funds when the amount of HUD assistance exceeds \$50,000 per full-time equivalent permanent job created or retained.

The City's Implementation Plan for the HUD 108 Real Estate Loan Program, which includes the Midtown Corporate Center project, is contained in the City's June 30, 2001 Annual Report to HUD. It states the baseline for the program is the revitalization of distressed urban neighborhoods by offering loan and grant incentives to Zone businesses while creating job opportunity for residents. A milestone of the Implementation Plan is that the Zone will create and retain 1,500 jobs for Zone residents by providing low interest loans and grants to 250 businesses utilizing the One Stop Career Center and other labor force partners. Furthermore, one of the outputs of the Implementation Plan is to create or retain 1,500 Zone jobs from loans. The Implementation Plan does not refer to providing goods or services to individuals.

Furthermore, the former Acting Director for the City's Zone said on December 19, 2002 that the Midtown Corporate Center project must meet the public benefit criteria for job creation and retention.

The City lacked documentation to support that it performed an analysis to determine that a minimum level of public benefits would be achieved by the Midtown Corporate Center project as required by 24 CFR Part 570.209(b). Specifically, the City did not determine whether the project's assistance would exceed \$50,000 per full-time equivalent, permanent job created or retained. Therefore, the City was required to show that the project would create or retain at least 60 (\$3,000,000 divided by \$50,000) jobs.

The June 30, 1998 Loan Agreement between the City and Midtown Associates, L.L.C., the administering entity of the Midtown Corporate Center, required Midtown to achieve the job creation and retention requirements by June 30, 2001. As of October 2002, documentation maintained by the City and Midtown Associates, L.L.C. showed that only four (6.7 percent) jobs were created or retained. Therefore, Midtown used \$2,754,996 (93.3 percent of \$3,000,000 minus \$47,164) of Loan Guarantee funds from the City's Zone Program without creating or retaining jobs.

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## Controls Over Lassi Enterprises, L.L.C. Project Were Not Adequate

The City did not maintain adequate controls over the Lassi Enterprises, L.L.C. project. The City improperly entered into a contract with Lassi for the acquisition of land for which a specific proposed use had not been determined. Therefore, Lassi inappropriately used \$2,000,000 of HUD funds from the City's Program to purchase land with no specific proposed use. The problem occurred because the City lacked effective oversight and controls to assure HUD funds for its Zone Program were used appropriately. As a result, HUD funds for the City's Zone Program were not used efficiently and effectively.

The City Lacked Adequate Controls Over Zone Funds

The City lacked adequate oversight of the Lassi Enterprises, L.L.C. project. The City executed a Loan and Grant Agreement on November 14, 2001 with Lassi Enterprises, L.L.C. to acquire land located on the southeast side of Euclid Avenue and East 55<sup>th</sup> Street that will lead to the construction of a major new commercial, industrial, research, or institutional development. The City provided \$2,000,000 in HUD funds (\$1,200,000 in Initiative Grant funds and \$800,000 in Section 108 Loan funds) from its Program for the project.

The City improperly entered into the Agreement with Lassi Enterprises, L.L.C. for the acquisition of land for which a specific proposed use had not been determined. Therefore, Lassi inappropriately used \$2,000,000 of HUD funds to purchase land with no specific proposed use. The Director of Lassi Enterprises, L.L.C. and the Senior Business Development Specialist of the City's Zone both said the land was purchased to be part of a land bank for future ideas

The former Acting Director of the City's Zone said the executive summary for the Lassi Enterprises, L.L.C. project shows a specific proposed use for the project. The executive summary states that Lassi Enterprises, L.L.C. can prepare the land to create a site for the construction of a high technology office and laboratory project. This is not a specific proposed use for the land. Furthermore, as of November 2002, Lassi still did not have a specific use for the land. The Director of Lassi Enterprise, L.L.C. said he

The City Could Not Provide Documentation That It Performed A Public Benefit Analysis For The

Project

did not yet have a specific project or co-developer selected. As a result, HUD funds for the City's Zone Program were not used efficiently and effectively.

The City lacked documentation to support that it performed an analysis to determine that a minimum level of public benefit would be achieved by the Lassi Enterprises project. Specifically, the City did not determine whether the project's assistance would exceed \$50,000 per full-time equivalent, permanent job created or retained. Therefore, the City was required to show that the project would create or retain at least 40 (\$2,000,000 divided by \$50,000) jobs.

As of November 2002, documentation maintained by the City and Lassi Enterprises, L.L.C. showed that no jobs were created or retained. The former Acting Director of the City Zone said the Lassi project has until December 31, 2004 to achieve the job creation and retention standard.

The City could not provide an explanation as to why it could not provide supporting documentation for the public benefit determination of the Lassi project. As a result, the City lacks assurance that HUD funds for the City's Program were used efficiently and effectively.

### **Auditee Comments**

[Excerpts paraphrased from the comments provided by the Director of the City's Department of Economic Development on our draft audit report follow. Appendix C, pages 100 to 104, 110, 117 to 119, 127, 128, 130, 132, and 137 to 139, contains the complete text of the comments for this finding.]

The City believes that it adhered to 24 CFR Part 570.209(b)(3) when it entered into a contract with Lassi Enterprises, L.L.C. for the acquisition of land. Lassi did appropriately use \$2,000,000 of HUD funds (\$1,200,000 in Initiative Grant funds and \$800,000 in Section 108 Loan funds) from the City's Program to purchase the land.

The Office of Inspector General incorrectly stated the land was acquired with no specific proposed use. The City's Initiative Grant Agreement, effective May 17, 1996, for the

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City's Zone Program defines specific proposed use for as a major industrial, research, or institutional development.

Midtown Cleveland formed Lassi Enterprises, Inc., its subsidiary, to acquire land for the development of a technology industrial park. Lassi Enterprises, L.L.C., purchased the land to be part of the MidTown Technology Center for the construction of 100,000 square foot of office and laboratory space.

The City adequately planned for the Lassi Enterprises, L.L.C. project. The project achieved the mandatory public benefit criteria established by 24 CFR Part 570.

24 CFR Part 570.209(b)(3) states an activity will be considered by HUD to provide insufficient public benefit and may under no circumstances be assisted with HUD funds when the amount of HUD assistance exceeds \$50,000 per full-time equivalent permanent job created or retained or \$1,000 per low and moderate-income person which goods or services are provided by the activity. The projects met the public benefit criteria for goods or services to low and moderate-income persons.

The Department of Economic Development – Empowerment Zone Executive Summary for the Lassi Enterprises, L.L.C. project demonstrates the City performed an analysis to determine the minimum level of public benefit that would be achieved by the project.

## OIG Evaluation Of Auditee Comments

The City's Initiative Grant Agreement, effective May 17, 1996, for the City's Zone Program does not define specific proposed use.

The City provided multiple documents showing that the land is to be used for the MidTown Technology Center, a 100,000 square foot technology building. The City did not provide documentation on the implementation of the proposed use of the land. Therefore, the City failed to adhere to 24 CFR Part 570.209(b)(3) when it entered into a contract with Lassi Enterprises, L.L.C. for the acquisition of land for which a <u>specific</u> proposed use had not been determined. Furthermore, Lassi inappropriately used

\$2,000,000 of HUD funds (\$1,200,000 in Initiative Grant funds and \$800,000 in Section 108 Loan funds) from the City's Zone Program to purchase land with no specific proposed use. The Director of Lassi Enterprises, L.L.C. and the Senior Business Development Specialist of the City's Zone both said the land was purchased to be part of a land bank for future ideas. As of November 2002, Lassi still did not have a specific use for the land. The Director of Lassi Enterprise, L.L.C. said he did not yet have a specific project or co-developer selected.

24 CFR Part 570.209(b)(3) states an activity will be considered by HUD to provide insufficient public benefit and may under no circumstances be assisted with HUD funds when the amount of HUD assistance exceeds \$50,000 per full-time equivalent permanent job created or retained.

The City provided the Department of Economic Development – Empowerment Zone's Executive Summary for the Lassi Enterprises, L.L.C. project. The Executive Summary did not show the City performed an analysis to determine that a minimum level of public benefit would be achieved by the project.

The City's Implementation Plan for the Acquisition and Development Loan Program, which includes the Lassi Enterprises, Inc. project, is contained in the City's June 30, 2002 Annual Report to HUD. One of the outputs of the Implementation Plan is to create or retain 200 Zone jobs from loans. The Implementation Plan does not refer to providing goods or services to individuals.

Furthermore, the former Acting Director for the City's Zone said on December 19, 2002 that the Lassi Enterprises, Inc. project must meet the public benefit criteria for job creation and retention.

The City lacked documentation to support that it performed an analysis to determine that a minimum level of public benefit would be achieved by the Lassi Enterprises, L.L.C. project as required by 24 CFR Part 570.209(b). Specifically, the City did not determine whether the project's assistance would exceed \$50,000 per full-time equivalent, permanent job created or retained. Therefore,

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the City was required to show that the project would create or retain at least 40 (\$2,000,000 divided by \$50,000) jobs.

## Controls Over Empowerment Zone Commercial Security Project Were Not Adequate

The City did not maintain adequate controls over the Empowerment Zone Commercial Security project. Uptown Cleveland Security Corporation, the administering entity for the project, lacked adequate documentation to support \$1,954,676 of Initiative Grant funds paid for expenses that benefited the City's Program. The problem occurred because the City lacked effective oversight and controls to ensure that Grant funds for its Zone Program were used appropriately. As a result, the City lacks assurance that Grant funds for the City's Zone Program were not used efficiently and effectively.

The City Lacked Adequate Controls Over Zone Funds

The City lacked adequate oversight of the Empowerment Zone Commercial Security project. The City executed a non-competitive Contract effective July 1, 1998 through June 30, 1999 with Uptown Cleveland Security Corporation, the administering entity for the Empowerment Zone Commercial Security project, to provide a commercial security patrol for the protection of businesses in the Zone. The City extended the services through June 30, 2001 with two contract modifications executed on September 13, 1999 and July 25, 2000. The City provided \$2,000,000 in Initiative Grant funds from its Program for the project.

Uptown Cleveland Security Corporation lacked sufficient documentation for the method of allocation utilized to support \$1,954,676 of Grant funds used to pay expenses and profit for the Empowerment Zone Commercial Security project. The expenses included the following: salaries for \$1,508,285; vehicles and equipment for \$249,094; health care for \$55,619; office for \$54,980; training for \$50,065; and professional fees of \$36,633.

The City awarded Uptown Cleveland Security Corporation the contract for the Empowerment Zone Commercial Security project without performing a cost or price analysis as required by 24 CFR Part 85.36(f). The City also did not adequately perform a contract closeout as required by the Contract to determine whether a price re-determination was needed for the Contract.

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The City could not provide an explanation as to why it paid Uptown Cleveland Security Corporation the project expenses and profit without a method of allocation. As a result, HUD lacks assurance whether Grant funds for the City's Zone Program were used efficiently and effectively.

### **Auditee Comments**

[Excerpts paraphrased from the comments provided by the Director of the City's Department of Economic Development on our draft audit report follow. Appendix C, pages 97, 102, 110, and 132, contains the complete text of the comments for this finding.]

The City did not enter into a non-competitive contract with Cleveland Security Corporation Empowerment Zone Commercial Security project. The City issued a Request for Proposal for commercial security patrol for the protection of businesses in the Empowerment Zone. Uptown Cleveland Security Corporation's response was the only response that included providing patrol cars seven days a week between the hours of 3:00 p.m. through 7:00 a.m. This is the reason the City selected Uptown Cleveland Security Corporation for the contract. The City determined that the contract was fair and reasonable based upon a comparison with the other bids received through the Request for Proposal process. The City met the requirements of 24 CFR Part 85.36.

## OIG Evaluation Of Auditee Comments

The City did not provide documentation for the procurement of the Empowerment Zone Commercial Security project contract. The City also did not provide documentation for the cost or price analysis for the Uptown Cleveland Therefore. Security contract. Corporation, the administering entity of the Empowerment Zone Commercial Security project, lacked sufficient documentation for the method of allocation utilized to support \$1,954,676 of Initiative Grant funds from the City's Zone Program used to pay expenses and profit for the Security project. Furthermore, the City awarded Uptown Cleveland Security Corporation the contract for the Empowerment Zone Commercial Security project without

performing a cost or price analysis as required by 24 CFR Part 85.36(f).

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## Controls Over Fairfax Renaissance Development Corporation Operating Project Were Not Adequate

The City did not maintain adequate controls over the Fairfax Renaissance Development Corporation Operating project. Fairfax Renaissance Development Corporation inappropriately used \$328,636 of Initiative Grant funds from the City's Program to pay expenses that were not part of its contract with the City. The City did not require Fairfax to remit the applicable amount of \$1,162,263 in Program income earned through the project. The City also inaccurately reported the actual progress of the project in its June 30, 2001 Annual Report. The City lacked adequate documentation to support the outputs, milestones, and sources of project funds from non-Zone grants. The problems occurred because the City lacked effective oversight and controls to assure that Grant funds from its Zone Program were used appropriately, Program income was remitted, and accurate information was included in the City's June 2001 Annual Report. As a result, Grant funds for the City's Zone Program were not used efficiently and effectively. The City also did not provide HUD with an accurate representation of the project.

The City Lacked Adequate Controls Over Zone Funds

The City lacked adequate oversight of the Fairfax Renaissance Development Corporation Operating project. The City executed a Contract effective February 7, 1996 with Fairfax Renaissance Development Corporation to provide activities for job retention, job creation, planning for Zone residents, and commercial and community development technical assistance and planning. The City provided \$1,590,071 in Initiative Grant funds for the project.

Fairfax Renaissance Development Corporation inappropriately used \$328,636 of Grant funds from the City's Zone Program for expenses of the Quincy Place project (Appendix B, page 38 provides an explanation of the project). The expenses included land acquisition of \$217,265 and architectural fees for \$111,372. However, these expenses were not permitted according to Fairfax's February 7, 1996 Contract with the City.

Furthermore, Fairfax determined the land could not be used for the Quincy Place project. Therefore, the land reverted back to the City. The City maintains the property in its land bank without a planned use as a Zone project and has not reimbursed its Zone Program for the cost of the land.

The former Acting Director for the City's Zone said the Fairfax Renaissance Development Corporation Operating project could use Grant funds from the City's Zone Program for expenses of the Quincy Place project. The former Acting Director also said that the expenses were included in the February 7, 1996 Contract's budget as Pre-Development Capacity Building. However, the Contract did not include a detailed description of the Pre-Development Capacity Building costs. Furthermore, 24 CFR Part 570.205 does not allow funding for capacity building activities to include land acquisition and architectural fees. As a result, Grant funds for the City's Zone Program were not used efficiently and effectively.

The City Did Not Ensure That Program Income Was Remitted To The City Fairfax Renaissance Development Corporation is fully funded with Initiative Grant funds from the City's Program and Community Development Block Grant funds. Fairfax receives fees for development services it performs. Fairfax received \$1,162,263 of development fees between 1996 and 2002. Fairfax did not remit any of the development fees to the City. These development fees were Program income. Fairfax could not provide documentation as to whether the Program income was generated from the Initiative Grant funds or the Block Grant funds.

Program income generated from development fees as a result of Fairfax Renaissance Development Corporation's use of Initiative Grant funds must be remitted to the City and deposited into a loan repayment account established by the City as required by the City's Initiative Grant Agreement with HUD and the February 7, 1996 Contract between the City and Fairfax.

The Director of the City's Department of Economic Development said he does not believe the development fees are Program income. As a result, fewer funds are available to the City as security for the repayment of its Loan Guarantee.

The City Inaccurately Reported The Project's Accomplishments The City incorrectly reported in its June 30, 2001 Annual Report the actual progress of the Fairfax Renaissance Development Corporation Operating project. The City reported the accomplishments for the project under the Zone Community Based Development Organizations

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Implementation Plan. The Plan included the accomplishments for all of the City's Zone Community Based Development Organization projects. The City lacked adequate documentation to support the outputs, milestones, and sources of project funds from non-Zone grants reported under the Zone Community Based Development Organizations Implementation Plan.

The City also inaccurately reported in its June 30, 2001 Annual Report the amount of project funds used by the Fairfax Renaissance Development Corporation Operating project. The City reported the Operating project used \$1,294,298. Documentation maintained by the City showed the project used \$1,590,071 as of June 30, 2001.

The former Director of the City's Zone said HUD directed them to report the Zone Community Based Development Organization projects in one Implementation Plan. former Director could not provide documentation to A Community Planning and support this statement. Development **Specialist** in HUD's Renewal Communities/Empowerment Zones/Enterprise Communities Initiative said a Zone is to report each project in its own Implementation Plan. Furthermore, page 2 of the Empowerment Zone and Enterprise Community Initiative Performance Measurement System guidance issued in April 2001 states Zones are required to create an Implementation Plan for each project undertaken.

The City could not provide supporting documentation for the information contained in the June 30, 2001 Annual Report. As a result, the City did not accurately report the accomplishments of their Program to HUD.

## **Auditee Comments**

[Excerpts paraphrased from the comments provided by the Director of the City's Department of Economic Development on our draft audit report follow. Appendix C, pages 104, 105, 110, 119, 120, 140, and 141, contains the complete text of the comments for this finding.]

Fairfax Renaissance Development Corporation appropriately used Initiative Grant funds from the City's Program for expenses of the Quincy Place project to carry

out management, coordination, and monitoring of activities necessary for effective planning implementation. The City disagrees with the Office of Inspector General because capacity building is permitted under 24 CFR Part 570.205.

The land acquired by Fairfax Renaissance Development Corporation reverted back to the City. The City plans to use the land for a public park.

The City's contracts with Community Development Corporations state there will be no program income in order for the Community Development Corporations to be self-sufficient when the City's Program ceases.

The definition of program income in 24 CFR Part 570.500(a)(4)(ii) excludes fees for development services.

Fairfax Renaissance Development Corporation is not fully funded with Initiative Grant funds and Community Development Block Grant funds. It is highly questionable that any portion of the fees for development services should be considered Program income since it is possible non-Federal funds supported the activities that generated the fees for development services.

The Office of Inspector General attributes the entire amount of the fees for development services to the City's Program and recommends the City resolve the matter with HUD. This does not appear to meet professional standards of auditing.

The City supports Fairfax Renaissance Development Corporation retaining project fees for development services. HUD's regulations and the intent of the Program do not conflict with this treatment of fees for development services.

## OIG Evaluation Of Auditee Comments

Fairfax Renaissance Development Corporation inappropriately used \$328,636 of Initiative Grant funds from the City's Program for expenses of the Quincy Place project. The expenses included \$217,265 for land acquisition and \$111,372 for architectural fees. These expenses were not

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permitted according to Fairfax's February 7, 1996 contract with the City.

The former Acting Director for the City's Zone said the expenses were included in the February 7, 1996 Contract's budget as Pre-Development Capacity Building. However, the Contract did not include a detailed description of the Pre-Development Capacity Building costs. Furthermore, 24 CFR Part 570.205 does not allow funding for capacity building activities to include land acquisition and architectural fees. As a result, Grant funds for the City's Zone Program were not used efficiently and effectively.

We adjusted our audit report by including the land reverted back to the City. The City did not provide documentation for the use of the land. Therefore, the City maintains the property in its land bank without a planned use for a Zone project and has not reimbursed its Program for the cost of the land.

We adjusted our report to include that Section 4.10 of the February 7, 1996 contract between the City and Fairfax Renaissance Development Corporation states program income includes income from service fees. Section 4.10 also states project income earned during the project period shall be retained by the City in accordance with the Initiative Grant Agreement.

Paragraph 6 of the Initiative Grant Agreement, effective May 17, 1996, for the City's Program states program income constitutes security for the repayment of the Section 108 Guarantee and will be deposited into a loan repayment account established by the City.

24 CFR 570.500(a)(4)(ii) states program income does not include amounts generated by activities that are financed by a loan guaranteed under section 108 of the Act. The Fairfax Renaissance Development Corporation Operating project was financed with Initiative Grant funds.

The City provided a letter from the Executive Director of Fairfax Renaissance Development Corporation and a schedule on Fairfax Renaissance Development Corporation's analysis of annual expenses versus Grant funds as of March 19, 2003 regarding the fees for development services. The

City did not provide supporting documentation for the letter and schedule.

Fairfax Renaissance Development Corporation is fully funded with Initiative Grant funds from the City's Program and Community Development Block Grant funds. Fairfax receives fees for development services it performs. Fairfax received \$1,162,263 in development fees between 1996 and 2002. Fairfax did not remit any of the development fees to the City. These development fees were Program income. Fairfax could not provide documentation as to whether the Program income was generated from Initiative Grant funds or Block Grant funds.

Program income generated from development fees as a result of Fairfax Renaissance Development Corporation's use of Zone funds must be remitted to the City and deposited into a loan repayment account established by the City as required by the City's Initiative Grant Agreement with HUD and the February 7, 1996 contract between the City and Fairfax.

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# Controls Over The Center For Employment Training - Cleveland, Inc. Project Were Not Adequate

The City did not maintain adequate controls over the Center for Employment Training – Cleveland, Inc. project. The Center for Employment Training, Inc. inappropriately used \$176,100 of Initiative Grant funds and lacked sufficient documentation to support another \$33,300 of Grant funds paid for expenses that benefited the City's Program. The City also inaccurately reported the actual progress of the project in its June 30, 2001 Annual Report. The City did not have adequate documentation to support the outputs, milestones, and uses of project funds. The problems occurred because the City lacked effective oversight and controls to assure that Grant funds for its Zone Program were used appropriately and accurate information was included in the City's June 2001 Annual Report. As a result, Grant funds for the City's Zone Program were not used efficiently and effectively. The City also did not provide HUD with an accurate representation of the project.

The City Lacked Adequate Controls Over Zone Funds

The City lacked adequate oversight of the Center for Employment Training – Cleveland, Inc. project. The City executed a Contract effective July 1, 1997 with the Center for Employment Training – Cleveland, Inc. to provide labor force development training for Zone residents. Attachment 1 of the Contract states the project will enroll 63 Zone residents. The City provided \$300,000 in Initiative Grant funds from its Program for the project.

The City requires the Zone residents to be processed through the One Stop Career Center. The Center for Employment Training – Cleveland, Inc. requires the Zone residents to attend 10 days of training to be considered enrolled in the training.

The Center for Employment Training – Cleveland, Inc. failed to enroll and provide any training to 27 eligible Zone residents, enrolled and provided training to five non-Zone residents, and provided training to five Zone residents who did not attend 10 days of training. Therefore, the Center inappropriately used \$176,100 (58.7 percent) of Grant funds from the City's Zone Program for the project when it failed to enroll 37 (58.7 percent) eligible Zone residents.

The Center for Employment Training – Cleveland, Inc. could not provide documentation that six of the Zone residents enrolled in and provided training were approved by the One Stop Career Center. Additionally, the Center provided the name of one individual in which it could not supply any documentation for enrollment and training. Therefore, the Center also lacked sufficient documentation to support \$33,300 (11.1 percent) of Grant funds were used to benefit the City's Zone Program.

The former Acting Director and the Labor Force Manger of the City's Zone said they believed that it was only a goal of the project to enroll 63 Zone residents. They did not believe that the project was required to accomplish this goal. As a result, Grant funds for the City's Zone Program were not used efficiently and effectively.

The City Inaccurately Reported The Project's Accomplishments The City inaccurately reported in its June 30, 2001 Annual Report the actual progress of the Center for Employment Training – Cleveland, Inc. project. The inaccuracies related to outputs, a milestone, and uses of project funds.

The City reported in its 2001 Annual Report for two outputs that 181 Zone residents were trained and 97 Zone resident trainees were placed in jobs. Documentation maintained by the Center for Employment Training – Cleveland, Inc. showed that 155 Zone residents were trained. Neither the City nor the Center could provide supporting documentation for the number of Zone resident trainees placed in jobs.

The City inaccurately reported the actual progress for the Center for Employment Training – Cleveland, Inc. project's milestone in its June 30, 2001 Annual Report. The City reported the project was 50 percent complete as of June 30, 2001 in providing skill training and job placement for 2,000 Zone residents in the fields of welding, precision metals, shipping/receiving, and printing. Documentation maintained by the Center for Employment Training – Cleveland, Inc. showed that the milestone was only eight percent complete as of June 2001.

The City also inaccurately reported in its 2001 Annual Report the amount of funds used by the Center for

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Employment Training – Cleveland, Inc. project. The City reported the project used \$736,375. Documentation maintained by the City showed the project used \$869,974.

The City could not provide an explanation for the inaccurate reporting in its June 30, 2001 Annual Report. As a result, the City did not accurately report the accomplishments of their Program to HUD.

### **Auditee Comments**

[Excerpts paraphrased from the comments provided by the Director of the City's Department of Economic Development on our draft audit report follow. Appendix C, pages 110 and 120 to 122 contains the complete text of the comments for this finding.]

The Office of Inspector General asserts that the City's Contract effective July 1, 1997 with the Center for Employment Training – Cleveland, Inc. required the project to enroll 63 Zone residents and that the City's Implementation Plan for the project relates entirely to Zone residents. The City's Contract with the Center is a cost based contract rather than a performance-based contract. The Contract does not require a fixed number of individuals to be trained. The Contract does reference the number of individuals to be trained.

The Center provided training to 32 eligible Zone residents. The City established a policy after it entered into the Contract with Center that the participants of the project had to complete a minimum of 10 days of training. Furthermore, this is a City policy in which the City could waive. Therefore, the City should not be required to reimburse Initiative Grant funds for Zone residents who did not attend 10 days of training.

The Office of Inspector General mistakenly assessed that the funding for the project did not benefit Zone residents.

Two of the six Zone residents enrolled and provided training that the Office of Inspector General reported the Center for Employment Training – Cleveland, Inc. could not provide documentation that they were approved by the One Stop Career Center. Approval by the One Stop Career Center is

policy established by the City. It is not a Federal requirement. Therefore, the City could waive the requirement and should not be required to reimburse Initiative Grant funds.

To the best of the City's knowledge, it did not under report the amount of project funds used by the Center for Employment Training – Cleveland, Inc. project in its June 2001 Annual Report.

## OIG Evaluation Of Auditee Comments

The City's Contract effective July 1, 1997 with the Center for Employment Training – Cleveland, Inc. required the project to enroll 63 Zone residents. We did not assert that the City's Implementation Plan for the Center for Employment Training – Cleveland, Inc. project relates entirely to Zone residents.

The Center requires that Zone residents to attend 10 days of training to be considered enrolled in the training. The Center provided training to 19 eligible Zone residents.

The Center inappropriately used \$176,100 of Initiative Grant funds from the City's Zone Program when it failed to enroll 37 eligible Zone residents.

The City provided a One Stop Career Center Referral Form, Progress Notes, a Center for Employment Training – Cleveland, Inc. Application, and a One Stop Career Center Progress Report. None of the documentation showed that the two Zone residents enrolled and provided training were approved by the One Stop Career Center. Therefore, the Center lacked sufficient documentation to support that \$33,300 of Initiative Grant funds were used to benefit the City's Zone Program.

The City did not provide documentation to support that it did not under report the amount of project funds in its June 2001 Annual Report.

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## Controls Over Vocational Guidance Services' Job Match Project Were Not Adequate

The City did not maintain adequate controls over the Vocational Guidance Services' Job Match project. Vocational Guidance Services inappropriately used \$86,398 of Economic Development Initiative funds that did not benefit the City's Program and did not match \$25,990 of Grant funds from the City's Zone Program with in-kind contributions. The City also inaccurately reported the actual progress of the project in its June 30, 2001 Annual Report. The City lacked adequate documentation to support an output, a milestone, and uses of project funds. The problems occurred because the City lacked effective oversight and controls to assure that Grant funds for its Zone Program were used appropriately and accurate information was included in the City's June 2001 Annual Report. As a result, Grant funds for the City's Zone Program were not used efficiently and effectively. The City also did not provide HUD with an accurate representation of the project and the reported benefits of the project are greater than actually achieved.

The City Lacked Adequate Controls Over Zone Funds

The City lacked adequate oversight of the Vocational Guidance Services' Job Match project. The City executed a Contract for the period July 1, 2000 through June 30, 2001 with Vocational Guidance Services to provide job assessment, referral, training, job placement, and retention for Zone residents. The City extended the Contract through August 31, 2001. The City provided \$850,936 in Initiative Grant funds from its Program for the project.

Vocational Guidance Services inappropriately used \$47,858 of Grant funds from the City's Zone Program for the Job Match project that did not benefit Zone residents. Documentation maintained by Vocational Guidance Services showed that 729 individuals enrolled in the Job Match project. Of the 729 individuals enrolled, 41 were non-Zone residents.

Vocational Guidance Services also inappropriately used \$36,609 of Grant funds from the City's Zone Program to pay indirect costs not allocable to the Job Match project. The following indirect costs were incorrectly allocated to the project by Vocational Guidance Services: depreciation from its non-Zone funded affiliated entities; the exclusion of rents and/or direct costs from its non-Zone funded affiliated entities in its indirect cost allocation; and the use

of an outdated indirect cost rate for the two month extension of the contract

Vocational Guidance Services did not match \$25,990 of Grant funds from the City's Zone Program with in-kind contributions as required. The City's Contract with Vocational Guidance Services, effective July 1, 2000, required it to match the Grant funds with \$27,712.

Furthermore, Vocational Guidance Services used \$1,931 of Grant funds from the City's Zone Program to pay indirect costs for drug testing fees already directly expensed for the project.

The City could not provide an explanation for non-Zone residents being enrolled in the Job Match project, paying indirect costs not allocable to the project, and Vocational Guidance Services not matching the Grant funds from the City's Zone Program. The Controller of the City's Zone said it was an oversight mistake to pay the indirect costs for drug testing fees already directly expensed for the project. As a result, Grant funds for the City's Zone Program were not used efficiently and effectively.

The City Inaccurately Reported Project's Accomplishments The City inaccurately reported in its June 30, 2001 Annual Report the actual progress of the Vocational Guidance Services' Job Match project. The inaccuracies related to an output, a milestone, and uses of project funds.

The City reported in its 2001 Annual Report for an output that 1,827 Zone residents were placed in jobs. Documentation maintained by Vocational Guidance Services showed that 1,116 Zone residents were placed in jobs.

The City reported in its June 30, 2001 Annual Report that the milestone of work with area businesses for the placement of 4,000 Zone residents in jobs was 75 percent complete as of June 2001. Documentation maintained by Vocational Guidance Services showed that the milestone was only 28 percent complete as of June 30, 2001.

The City reported in its 2001 Annual Report the Job Match project used \$16,128,690. Documentation maintained by

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the City as of June 30, 2001 estimated project used \$2,728,750.

The City lacked effective oversight and controls to assure accurate information was included in the City's June 2001 Annual Report. As a result, the City did not accurately report the accomplishments of its Program to HUD. The impression exists that the benefits of the City's Program were greater than actually achieved.

### **Auditee Comments**

[Excerpts paraphrased from the comments provided by the Director of the City's Department of Economic Development on our draft audit report follow. Appendix C, pages 120 and 122 to 125, contains the complete text of the comments for this finding.]

Sixteen of the 50 individuals enrolled in Vocational Guidance Services' Job Match project that the Office of Inspector General reported as non-Zone residents were Zone residents. An additional 16 individuals enrolled in the project were non-Zone residents residing on the Zone's border. The City believes Federal regulations and the City's Initiative Grant Agreement, effective May 17, 1996, for the City's Program do not restrict the use of Zone funds for Zone residents. Furthermore, HUD's approval of the Buffer Zone recognized the need and importance of extending the benefits of the Zone into the surrounding areas.

The City does not agree that Vocational Guidance Services inappropriately used \$36,609 of Initiative Grant funds from the City's Zone Program to pay indirect costs not allocable to the Job Match project. Vocational Guidance Services allocated depreciation across functional cost centers, but included all depreciation in the indirect cost pool. Depreciation is not included as a direct cost to the Job Match project. Vocational Guidance Services credits intercompany rents to offset certain expenses incurred and included the direct expenses from Sunbeam Shop in its 1999 direct cost base. Attachment A of Office of Management and Budget Circular A-122 states predetermined fixed rates are not subject to adjustment.

Vocational Guidance Services was not required to match \$27,712 of Initiative Grant funds from the City's Zone Program with in-kind contributions. Vocational Guidance Services was responsible for indirect costs should the actual project expenses exceed the Grant funding.

Vocational Guidance Services used Initiative Grant funds efficiently and effectively and the City has take the necessary steps to assure that effective oversight and controls are in place at all times.

Vocation Guidance Services derived drug testing fees from services provided specifically for the project by other agencies. The drug-testing fee of a minimum of \$50 included, but was not limited to, test materials, lab reports, verification, and a chemical dependency counselor, if necessary.

The Office of Inspector General incorrectly asserts that the City's Initiative Grant Agreement, effective May 17, 1996, for the City's Program relates entirely to Zone residents. The Office of Inspector General relies on Attachment A, paragraph C(1)(a), Office of Management and Budget Circular A-87.

To the best of the City's knowledge, it accurately reported the information for the Vocational Guidance Services' Job Match project in its June 2001 Annual Report.

## OIG Evaluation Of Auditee Comments

Of the 50 individuals enrolled in the Vocational Guidance Services' Job Match project that we determined to be non-Zone residents, the City provided documentation that nine of the individuals were Zone residents. Therefore, we reduced the amount of Initiative Grant funds from the City's Zone Program that Vocational Guidance Services inappropriately used for the Job Match project by \$10,505. The documentation the City provided for the remaining seven individuals enrolled in the project that the City claimed were Zone residents was not sufficient to support that the individuals were indeed Zone residents. Therefore, Vocational Guidance Services inappropriately used \$47,858 of Initiative Grant funds from the City's Zone Program for its

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Job Match project that did not benefit Zone residents. Documentation maintained by Vocational Guidance Services showed that 729 individuals were enrolled in the Job Match project. Of the 729 individuals, 41 were non-Zone residents.

The City executed a Contract for the period July 1, 2000 through June 30, 2001 with Vocational Guidance Services to provide job assessment, referral, training, job placement, and retention for Zone residents.

HUD only granted the City to extend approved economic development lending activities eligible under 24 CFR Part 570.703(I)(1) to the Buffer Zone.

The City lacked sufficient documentation to support its assertions regarding Vocational Guidance Services use of Initiative Grant funds from the City's Zone Program to pay for indirect costs not allocable to the Job Match project. Therefore, Vocational Guidance Services failed to meet Office of Management and Budget A-87, Attachment A, paragraph C(3)(a), when it used \$36,609 of Initiative Grant funds from the City's Zone Program to pay indirect costs not allocable to the Job Match project. The following indirect costs were incorrectly allocated to the project by Vocational Guidance Services: depreciation from its non-Initiative Grant funded affiliated entities; the exclusion of rents and/or direct costs from its non-Initiative Grant funded affiliated entities in its indirect cost allocation; and the use of an outdated indirect cost rate for the two month extension of the contract.

Vocational Guidance Services did not match \$25,990 of Initiative Grant funds from the City's Zone Program with in-kind contributions as required. Vocational Guidance Services contract for the project required it to match the Grant funds with \$27,712.

The City did not provide supporting documentation for the drug testing fees. Therefore, Vocational Guidance Services used \$1,931 of Initiative Grant funds from the City's Zone Program to pay indirect costs for drug testing fees already directly expensed for the project.

The City did not provide documentation to support that it accurately reported the information for the Vocational

Guidance Services' Job Match project in its June 2001 Annual Report.

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# Controls Over IMR Global – Orion Consulting, Inc. And The Reserve Network Bank Teller Job Training Project Were Not Adequate

The City did not maintain adequate controls over the IMR Global – Orion Consulting, Inc. and The Reserve Network Bank Teller Job Training project. Orion Consulting, Inc., the administering entity for the project, used \$25,095 of Initiative Grant funds to pay expenses that did not benefit the City's Program. The City also inaccurately reported the actual progress of the project in its June 30, 2001 Annual Report. The inaccuracies related to outputs, milestones, and sources and uses of project funds. The problems occurred because the City lacked effective oversight and controls to assure that Grant funds for its Zone Program were used appropriately and accurate information was included in the City's June 2001 Annual Report. As a result, Grant funds for the City's Zone Program were not used efficiently and effectively. The City also did not provide HUD with an accurate representation of the project.

The City Lacked Adequate Controls Over Zone Funds

The City lacked adequate oversight of the IMR Global – Orion Consulting, Inc. and The Reserve Network Bank Teller Job Training project. The City executed a Contract effective May 1, 1998 with Orion Consulting, Inc. and The Reserve Network for \$90,790 to provide bank teller job training to 45 Zone residents determined eligible by the One Stop Career Center. The City provided \$85,652 in Initiative Grant funds from its Program for the project. The City did not provide the project the remaining \$5,138 of Grant funds.

Orion Consulting, Inc., the administering entity of the IMR Global – Orion Consulting, Inc. and The Reserve Network Bank Teller Job Training project, used Grant funds that did not benefit the City's Zone Program. Orion provided documentation that there were 41 participants in the Bank Teller Job Training project. Only 30 of the 41 participants were Zone residents determined eligible by the One Stop Career Center. The remaining 11 participants consisted of: six non-Zone residents; four Zone residents approved by the Center who signed up for but did not attend the training; and one Zone resident not approved by the Center. Orion also failed to provide training to an additional four Zone residents. Therefore, Orion failed to provide bank teller job training to 15 (33.3 percent) Zone residents determined to be eligible by the One Stop Career Center and also

inappropriately used \$25,095 (\$90,790 times 33.3 percent minus \$5,138) of Grant funds that did not benefit the City's Zone Program.

The City could not provide an explanation as to why it paid Orion Consulting, Inc. for project expenses when eligible Zone residents were not being trained. As a result, Grant funds for the City's Zone Program were not used efficiently and effectively.

The City Inaccurately Reported The Project's Accomplishments The City incorrectly reported in its June 30, 2001 Annual Report the actual progress of the IMR Global - Orion Consulting, Inc. and The Reserve Network Bank Teller Job Training project. The City reported the accomplishments for the project under the One Stop Career Center Implementation Plan Plan. The included the accomplishments of labor force development projects. The City lacked adequate documentation to support the outputs, milestones, and sources and uses of project funds from non-Zone Grants reported under the One Stop Career Center.

The former Director of the City's Zone said HUD directed them to report the labor force development projects in one Implementation Plan. The former Director could not provide documentation to support this statement. Community Planning and Development Specialist in Communities/Empowerment HUD's Renewal Zones/Enterprise Communities Initiative said a Zone is to report each project in its own Implementation Plan. Furthermore, page 2 of the Empowerment Zone and Enterprise Community Initiative Performance Measurement System guidance issued in April 2001 states Zones are required to create an Implementation Plan for each project undertaken

The City could not provide supporting documentation for the accomplishments reported under the One Stop Career Center Implementation Plan in its June 30, 2001 Annual Report. As a result, the City did not accurately report the accomplishments of their Program to HUD.

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### **Auditee Comments**

[Excerpts paraphrased from the comments provided by the Director of the City's Department of Economic Development on our draft audit report follow. Appendix C, pages 110, 125, and 126, contains the complete text of the comments for this finding.]

The City required the IMR Global – Orion Consulting, Inc. and The Reserve Network Bank Teller Job Training project to provide training to individuals determined to be eligible by the One Stop Career Center. This was not a Federal requirement. Therefore, the City could waive the requirement and should not be required to reimburse Initiative Grant funds

One of the six participants in the Bank Teller Job Training project that the Office of Inspector General reported as non-Zone residents was a Zone resident. An additional four participants in the project were non-Zone residents residing on the Zone's border.

## OIG Evaluation Of Auditee Comments

We did not assert that the City's Initiative Grant Agreement, effective May 17, 1996, for the City's Program relates entirely to Zone residents. We also did not rely on Attachment A, paragraph C(1)(a), Office of Management and Budget Circular A-87, with respect to the IMR Global – Orion Consulting, Inc. and The Reserve Network Bank Teller Job Training project.

The City executed a Contract effective May 1, 1998 with Orion Consulting, Inc. and The Reserve Network to provide bank teller job training to 45 Zone residents determined to be eligible by the One Stop Career Center.

We adjusted our report by reducing the number of Zone residents determined to be eligible by the One Stop Career Center that Orion failed to provide bank teller job training to by one and the amount of Initiative Grant funds that did not benefit the City's Zone Program by \$2,088.

Orion Consulting, Inc. used Initiative Grant funds from the City's Zone Program that did not benefit the City's Zone

Program. Orion provided documentation that there were 41 participants in the Bank Teller Job Training project. Only 30 of the 41 participants were Zone residents determined to be eligible by the One Stop Career Center. The remaining 11 participants consisted of the following: six non-Zone residents; four Zone residents approved by the Center who signed up for but did not attend the training; and one Zone resident not approved by the Center. Orion also failed to provide training to an additional four Zone residents. Therefore, Orion failed to provide bank teller job training to 15 (33.3 percent) Zone residents determined eligible by the One Stop Career Center and also inappropriately used \$25,095 (\$90,790 times 33.3 percent minus \$5,138) of Initiative Grant funds that did not benefit the City's Zone Program.

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## Controls Over Hough Area Partners In Progress Operating Project Were Not Adequate

The City did not maintain adequate controls over the Hough Area Partners In Progress Operating project. The City lacked documentation to support \$1,852 of Initiative Grant funds paid for expenses that benefited the City's Program. The City also inaccurately reported the actual progress of the project in its June 30, 2001 Annual Report. The inaccuracies related to outputs, milestones, and sources of project funds from non-Zone grants. The problems occurred because the City lacked effective oversight and controls to assure that Grant funds for its Zone Program were used appropriately and accurate information was included in the City's June 2001 Annual Report. As a result, Grant funds for the City's Zone Program were not used efficiently and effectively. The City also did not provide HUD with an accurate representation of the project.

The City Lacked Adequate Controls Over Zone Funds

The City lacked adequate oversight of the Hough Area Partners In Progress Operating project. The City executed a Contract effective September 1, 1996 with Hough Area Partners In Progress to provide activities for job retention, job creation, planning for Zone residents, commercial and community development technical assistance and planning. The City provided \$1,007,224 in Initiative Grant funds from its Program for the project.

The City lacked documentation to support Hough Area Partners In Progress used \$1,852 of Grant funds from the City's Zone Program to pay expenses of the Operating project. Hough Area Partners In Progress is no longer in operation. Therefore, we were unable to review documentation maintained by Hough Area Partners In Progress.

The City could not provide an explanation for the missing documentation. As a result, the City lacks assurance that Grant funds for its Zone Program were used efficiently and effectively.

The City Inaccurately Reported The Project's Accomplishments The City incorrectly reported in its June 30, 2001 Annual Report the actual progress of the Hough Area Partners In Progress Operating project. The City reported the accomplishments for the project under the Zone Community Based Development Organizations Implementation Plan. The Plan included the accomplishments for all of the City's

Zone Community Based Development Organization projects. The City did not have adequate documentation to support the outputs, milestones, and sources of project funds from non-Zone grants reported under the Zone Community Based Development Organizations Implementation Plan.

The former Director of the City's Zone said HUD directed them to report the Zone Community Based Development Organization projects in one Implementation Plan. The former Director could not provide documentation to support this statement. A Community Planning and Development Specialist in HUD's Renewal Communities/Empowerment Zones/Enterprise Communities Initiative said a Zone is to report each project in its own Implementation Plan. Furthermore, page 2 of the Empowerment Zone and Enterprise Community Initiative Performance Measurement System guidance issued in April 2001 states Zones are required to create an Implementation Plan for each project undertaken.

The City could not provide supporting documentation for the accomplishments reported under the Zone Community Based Development Organizations Implementation Plan in its June 30, 2001 Annual Report. As a result, the City did not accurately report the accomplishments of their Program to HUD.

### **Auditee Comments**

[Excerpts paraphrased from the comments provided by the Director of the City's Department of Economic Development on our draft audit report follow. Appendix C, pages 110, 134, and 135, contains the complete text of the comments for this finding.]

The City provided \$610,506 for the City's Contract effective September 1, 1996 with the Hough Area Partners In Progress. The \$610,506 included \$585,506 of Initiative Grant funds and \$25,000 of Health and Human Services Title XX Grant funds. The City provided documentation supporting \$583,654 of the expenses from Initiative Grant funds.

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## OIG Evaluation Of Auditee Comments

The City's supporting documentation that \$25,000 of the \$610,506 provided for the Hough Area Partners In Progress Operating project was from Health and Human Services Title XX Grant funds. Therefore, we adjusted our report by reducing the amount of Initiative Grant funds from the City's Program provided for the project by \$25,000. We also adjusted our report by reducing the amount of Grant funds the City lacked documentation support for by \$25,000. The City lacked documentation to support Hough Area Partners In Progress used \$1,852 of Initiative Grant funds from the City's Program to pay expenses of the Operating project. Hough Area Partners In Progress is no longer in operation. Therefore, we were unable to review documentation maintained by Hough Area Partners In Progress.

## **Auditee Comments**



### City of Cleveland

Jane L. Campbell, Mayor

Department of Economic Development

Steven Sims, Director 601 Lakeside Avenue, Room 210 Cleveland, Ohio 44114-1015 216/664-2406 • Fax: 216/664-3681 www.city.cleveland.oh.us

Mr. Edward Kim

March 19, 2003

Assistant Regional Inspector General for Audit U.S. Department of HUD – Office of Inspector General 200 North High Point, Room 334 Columbus, Ohio 43214

Re: Office of Inspector General Audit Report of the City of Cleveland Empowerment Zone Program

Dear Mr. Kim:

The enclosed documentation included in four boxes shipped by Federal Express is provided to support \$1,800,875 in project costs, and for review and consideration with respect to the substantially eliminating any finding by the Office of Inspector General (OIG) in its Audit Report of the City of Cleveland Empowerment Zone Program, as related to a concern about the method of allocation utilized to support the grant funds used to pay expenses and profit for the Empowerment Zone Commercial Security Project, which was contracted to Uptown Cleveland Security Corporation. Included for consideration are schedules detailing the accumulation of costs by contracted budget line item that is fully referenced to supporting documents that includes copies of timesheets, payroll registers, paid invoices and cancelled checks.

The information was compiled in response to the "Draft Finding Outline" that the OIG provided to the City, as a preliminary indication of its proposed audit findings. We postponed submitting the documentation at the request of OIG auditors, but find it vital and critical to a proper understanding of the situation to transmit that the information in advance of providing our formal response, so that it can be fully considered and the Draft Audit Report revised accordingly.

We believe that this additional information largely satisfies the concern raised in the Draft Audit Report provided to the City, and we respectfully request the OIG revise its finding on this item prior to our having to submit a formal response for the Audit Report.

Sincerely,

Steven Sims, Director

Department of Economic Development

cc: Heath Wolfe, Regional Inspector General for Audit, Region V

Sharon Dumas, Director, Empowerment Zone Teresa Beasley, Chief Assistant Law Director

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### City of Cleveland

Jane L. Campbell, Mayor

Department of Economic Development Steven Sims, Director 601 Lakeside Avenue, Room 210 Cleveland, Ohio 44114-1015 216/664-2406 • Fax: 216/664-3681 www.city.cleveland.oh.us

March 28, 2003

### **VIA HAND DELIVERY**

Mr. Edward Kim Assistant Regional Inspector General for Audit US Department of Housing and Urban Development Office of Inspector General for Audit, Midwest The Bricker Federal Building 200 North High Street, Room 334 Columbus, Ohio 43215-2499

> Re: <u>Draft Audit Report of the Cleveland, Ohio Empowerment</u> Zone dated March 11, 2003

Dear Mr. Kim:

On behalf of the City of Cleveland ("City") and the staff of the City's Empowerment Zone, the City acknowledges receipt of the draft Audit Report of the Office of Inspector General (the "OIG") dated March 11, 2003 and received by the City on March 12, 2003 (the "Audit"). Please consider this as the City's formal written response to the OIG's findings and recommendations (the "Response"). This transmittal letter briefly addresses some of the major concerns arising from the Audit. However, our complete Response is provided in the discussion and information included with this transmittal.

The City would first like to take the opportunity to thank the OIG for the amount of time invested, as well as bringing certain items to the City's attention. While the City recognizes the insight, benefit and opportunity for improvement that any such audit might provide, it is regrettable that this first audit of the Empowerment Zone comes so close to the end of the City's program.

As a result of preliminary discussions with the OIG, the recommendations set forth in the Audit will allow for proper planning of the City's Empowerment Zone's expiration on December 31, 2005. The City will implement steps to more fully assure (1) an efficient and effective program, (2) that such operations appropriately use federal funds and provide benefit to the Empowerment Zone, (3) data included in the Annual Report is valid and reliable, (4) the program complies with all applicable laws and regulations, (5) that resources are properly safeguarded to include the appropriateness of expenditures and supporting documentation, and (6) the City's EDI

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Grant Agreement E-95-EZ-39-004 by and between the City and HUD (the "Grant Agreement") and City contracts are understood, followed and/or amended, where appropriate.

The City has hired an outside consultant to review and analyze the Empowerment Zone's processes and controls, and to make recommendations, where necessary. This will better strengthen the management and oversight of the Empowerment Zone. Mayor Jane L. Campbell appointed Steven Sims to Director of the City's Department of Economic Development in September 2002. Mr. Sims holds a CPA Certificate from the State of Ohio and his work experience includes public accounting, commercial banking and finance. He has audited large and medium-sized businesses, and worked in areas that include Strategic Financial Management and Public Finance. Mr. Sims previously served as the Director of Cuyahoga County's Department of Development, where he oversaw areas that included Community and Economic Development, Housing Finance, Workforce Initiatives, Airport, Sanitary Engineering, and Finance & Administration.

The City also recently appointed Sharon A. Dumas as the Director of the City's Empowerment Zone, which is under the supervision and monitoring of the Department of Economic Development. Ms. Dumas is responsible for the day-to-day management and administration of the City's Empowerment Zone Office. Ms. Dumas most recently served as the Assistant Director of the Community Development Department and was responsible for the administration of community development block grant ("CDBG") funds and related federal regulations. Because of her strong working knowledge of federal regulations with CDBG funds, as well as City policies and procedures, Ms. Dumas is an ideal person to serve as the Director of the City's Empowerment Zone.

The OIG's proposed findings severely limits the Congressional intent of the Empowerment Zone and implementation of the program by HUD. The narrow interpretations contained in the Audit severely constrict the program. These interpretations would strangle its purpose and hamper the reach of the City's revitalization efforts. Further, the City takes exception to the broad and overreaching conclusions expressed in the Audit such as statements indicating that the City's use of HUD funds expended through its Empowerment Zone program did not benefit the City's Empowerment Zone.

Finding 1 - Controls Over HUD Funds Were Not Adequate

### City's Response:

 The Audit does not demonstrate that the relocation of the County's Neighborhood Family Service Center to Quincy Place, or the City's Empowerment Zone into the Midtown Corporate Center resulted in a reduced employment level outside the Empowerment Zone.

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- Quincy Place and Glenville Towne Center satisfy the public benefit criteria under the provision of goods and services. The City will seek HUD's approval to classify the projects on this basis.
- Midtown Corporate Center, Quincy Place and Lassi have until December 2004, to meet the job creation requirement.
- The City has provided ample documentation with respect to the Uptown Security issue that supports the distribution of funds from the City to Uptown Security.

#### **Anti-Relocation**

The proposed Audit findings on two large projects - Quincy Place and Midtown Corporate Center - are based on the applicability of a regulation that restricts assistance to businesses and organizations that move into the Empowerment Zone, and that result in a decrease of their employment levels outside the Empowerment Zone. The City disagrees with the OIG's conclusions with respect to the regulation.

Contrary to the OIG's contention, it does not demonstrate that the relocation of the County's Neighborhood Family Service Center to Quincy Place resulted in a reduced employment level by the County outside the Empowerment Zone. The Cuyahoga County's Neighborhood Family Service Center was located at Quincy Place pursuant to an overall decentralization plan that Cuyahoga County undertook in response to Welfare Reform, and its initiatives to move people from welfare to work. It is clear that locating vital social and employment services closer to our customers would better serve Empowerment Zone residents. The OIG admitted that it never conducted an employment analysis to determine whether or not the move of the Neighborhood Family Service Center into Quincy Place resulted in a reduced employment level by the County outside the Empowerment Zone.

The Midtown Corporate Center Project preceded the applicability date of the anti-relocation regulation to the City's Empowerment Zone, January 1, 2000. As such, the regulation did not apply to the project or the City's relocation of its Empowerment Zone Office. Even if the regulation does apply, the relocation of the City's Empowerment Zone Office to the Midtown Corporate Center did not reduce the number of persons employed by the City of Cleveland outside the Empowerment Zone. The relocation of City Architecture to the Midtown Corporate Center also did not violate the regulation because it previously had been located at an address within the Buffer Zone of the Empowerment Zone. Moreover, the OIG admitted it never conducted an employment analysis to determine whether or not the move of the City's Empowerment Zone into the Midtown Corporate Center resulted in a reduced employment level by the City.

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Mr. Edward Kim March 27, 2003 City of Cleveland's Response to Audit Page 4 of 9

The OIG's concern that the Midtown Corporate Center Project did not demonstrate that two of the tenants -- City Architecture and the City's Empowerment Zone -- created or retained new jobs is unsupported. The City provided documentation showing that the project retained sixty-three jobs while creating ten. The City fully anticipates that these numbers will improve as the local real estate market and economic conditions improve. Also, Midtown Corporate Center continues to aggressively market its available space. The current shortfall in jobs created reflects the fact that Healthsync.com entered into a lease with Midtown Corporate Center but unfortunately went bankrupt shortly after moving into the space and closed. Finally, Midtown Corporate Center has until December 2004, to meet the job creation requirement.

#### Acquisition of Land

A question that has lead to a proposed Audit finding on another large project — Lassi/Midtown Technology Center - relates to the regulation that prohibits the use of federal funds to acquire land without a specific proposed use. The project involves the acquisition, remediation and demolition of approximately 13.8 acres of land and property along the City of Cleveland's Euclid Corridor for the development of a technology center. There clearly was a specific proposed use for the property acquired.

The apparent concern of OIG was that the specific parcel located on the south side of the street has not yet been developed. This reflects the fact that development of the project is being done in two (2) distinct phases, and work has focused primarily on Phase I located on the north side of the street. Nonetheless, the City is committed to the entire development of the Midtown Technology Park. Phase I will entail the renovation of a historic building into 400,000 square feet of office and laboratory buildings on 7.5 acres on the north side of Euclid Avenue, and Phase II will include the construction of 100,000 square feet of office and laboratory on the south side of the street. It is estimated that the project will create at least 100 full time jobs.

### Public Benefit Criteria

The Audit asserts that the Quincy Place, Glenville Towne Center and Lassi Projects do not comply with the public benefit regulation. Under the federal regulations, the required "public benefit" can be satisfied through the provision of jobs, either retained or created, or the provision of goods or services. The City believes that HUD will allow the City to satisfy the "public benefit" of the provisions of goods and services -- rather than job retention and creation. On this basis, **Quincy Place and Glenville Towne Center will satisfy the public benefit under the provision of services.** Finally, the Quincy Place, Lassi, and Glenville Projects each have

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Mr. Edward Kim March 27, 2003 City of Cleveland's Response to Audit Page 5 of 9

# until December 2004 to fulfill the public benefit requirement based strictly on job creation.

#### Record Keeping

The OIG took exception to the Uptown Security project on the basis of undocumented expenses. The City has provided substantial documentation as a part of its Response to the OIG. The documentation supports the distribution of funds to Uptown by the City, including schedules and detailed records of payroll and other expenses. The City believes on the basis of the documentation included with this Response, this finding will be significantly reduced or eliminated upon review by HUD. The OIG further contends that the City executed a non-competitive contract with Uptown Security. This is not true. The City issued a Request for Proposal to procure these services and selected Uptown because it was the only responder to provide patrol cars, seven days a week between the hours of 3:00 p.m. through 7:00 a.m.

In recent discussions with respect to the documentation provided in advance of this Response, the OIG has misinterpreted the terms and conditions of the City's contract with Uptown, specifically the fee for services rendered concept, and has placed additional, inappropriate requirements on the City. Further, the OIG has ignored detailed documentation and has been unreasonable and inaccurate in their assessment of the documentation.

**Finding 2** - The City Inaccurately Reported the Accomplishments of Its Empowerment Zone Projects

#### City's Response:

- The City has hired an outside consultant to review its processes and control.
- The issues with the reporting format were corrected in the June 30, 2002
   Annual Report.

#### **Annual Report**

The City is committed to any improvements necessary in its reporting to HUD. An outside consultant will be used to review the Empowerment Zone's processes and controls and reporting mechanisms. This will allow the City to implement modified and new controls where needed, that will ensure the accuracy of information submitted to HUD, and make certain that the staff responsible for preparing the Annual Report use accurate accomplishments to report each project. The City also is committed to verifying and correcting, where needed, the progress, outputs, milestones, sources and uses previously reported to HUD to the extent possible and practical. Some of the historical issues with the reporting dealt with confusion concerning the reporting

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structure required by HUD. The City prepared its June 30, 2001 Annual Report under a framework it believes HUD recommended at that time. The issues with the reporting format were corrected in the June 30, 2002 Annual Report.

**Finding 3 -** The City Provided HUD Funds to Projects That Have Not Benefited Zone Residents or Benefited Only 25 Percent of Zone Residents

## City's Response:

- The City strongly asserts that Empowerment Zone residents have and will
  continue to greatly benefit from the projects cited, well beyond the
  measure and perspective taken by the OIG.
- Quincy Place provides significant benefit to Empowerment Zone residents by having the County's Neighborhood Family Services Center located in the neighborhood.
- Glenville Towne Center, located in the heart of the Empowerment Zone, provides a retail-shopping venue that did not previously exist, and is built in a place where previous slum and blight conditions largely existed.
- The Lassi Project (a.k.a. Midtown Technology Center) will spur jobs and serve as a catalytic project that will result in additional business and neighborhood investments.

## Benefits to Empowerment Zone

The OIG focuses on the Quincy Place, Lassi and Glenville Projects and asserts that because the individual projects may not yet have met every contractual or regulatory requirement, the projects did not benefit Empowerment Zone residents or only benefited 25% of Empowerment Zone residents. The City strongly asserts that Empowerment Zone residents have and will continue to greatly benefit from the projects cited, well beyond the measure and perspective taken by the OIG. With regard to the OIG's contention that none of the contracts required the projects to create jobs that will be predominately held by Empowerment Zone residents, the OIG admits that the Grant Agreement does not provide a definition for "predominately held" and that HUD must make a determination whether the City's use of HUD funds for the three projects was appropriate. The City fully expects a favorable determination by HUD on this issue.

The City believes all areas that comprise the Empowerment Zone have seen measurable revitalization, which has both individually and collectively, provided substantial benefits to Empowerment Zone residents. Quincy Place provides significant benefit to Empowerment Zone residents by having the County's Neighborhood Family Services Center located in the neighborhood. The residents now have more convenient accessibility to social, employment and training

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services, and the building is a symbol of revitalization while serving as an anchor for additional development that is planned for the neighborhood.

Similarly, Glenville Towne Center, located in the heart of the Empowerment Zone, provides a retail-shopping venue that did not previously exist, and is built in a place where previous slum and blight conditions largely existed. Now Empowerment Zone residents have a needed asset in their neighborhood that provides vital services. This has added a sense of economic vitality to the Empowerment Zone. Lastly, the Lassi Project (a.k.a. Midtown Technology Center) will spur jobs and serve as a catalytic project that will result in additional businesses and neighborhood investments.

Finding 4 - The City Did Not Ensure That Program Income Was Remitted

#### City's Response:

- The City has several options under federal regulations on how to treat program income earned by subreciepents including allowing them to retain any such amount.
- The City supports allowing Fairfax to retain project development fees, and sees no conflict with HUD regulation or the intent of the Empowerment Zone Program in so doing.
- The OIG has admitted that it was unable to determine what portion of any such development fees, if any, might apply to the Empowerment Zone.

#### Program Income

The City disagrees with the OIG's categorization of certain earnings of Fairfax Renaissance Development Corporation ("Fairfax") as program income, and therefore the need to remit such amounts for deposit into a loan repayment account. The issue involves whether development fees earned by the agency meet the definition of program income under federal regulations. The City believes the fees are excluded from the definition. It is even more questionable that any portion of the development fee should be considered program income because Fairfax funded its operations with sources other than federal monies. **Moreover, the OIG has admitted that it was unable to determine what portion of any such development fees, if any, might apply to the Empowerment Zone.** 

Should the development fees be treated as program income, which the City believes it should not, the City has several options under federal regulations on how to treat program income earned by subreciepents including allowing them to retain any such amount. The City supports allowing Fairfax to retain project development fees, and sees no conflict with HUD regulation or the intent of the Empowerment Zone Program in so doing. The original proposed treatment of program

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income, as included in the City's Grant Agreement with HUD and between the City and Fairfax, dates back to 1995-1996, and was a policy decision -- not a regulatory requirement.

The policy was established to provide a possible additional revenue source that might be needed to support the City's loan repayments to HUD. It now appears, and the City will verify through its outside consultant, that the City should have sufficient sources to repay its obligation to HUD without requiring that local Community Development Corporations (CDCs) remit program income to the City for deposit. At the time the policy was established, the City neither anticipated that CDCs would earn development fees on projects or that such fees might be categorized as program income. The City remains committed to capacity building and ensuring that CDCs can sustain their work beyond the life of the Empowerment Zone funding.

The City also remains committed to the strategic vision and critically important thrusts set-forth in its Empowerment Zone program. The City has also worked diligently to create an environment that allows Empowerment Zone residents to improve their community and life potential by helping them gain access to resources that include jobs, money, information and self-esteem – all things that enable individuals to take control of their lives and improve their lot.

The benefit that the Empowerment Zone provides is best measured by the success of an approach to strengthen families and an individual's basic support system. Jobs are critical but cannot be considered in a vacuum. In addition to generating employment for residents, any meaningful employment strategy must also address those factors that diminish or enhance the economic opportunities of a community or its residents. This includes the service needs of neighborhoods and area businesses, and the ability of residents to qualify for – and keep – those jobs. A key Empowerment Zone goal is that its impact is seen, felt, and lasts long beyond the funding period.

In closing, the City appreciates the consideration and opportunity that the OIG has provided for the City's input. As indicated by our comments herein, the City believes there are areas of the Audit that merit reconsideration and substantially impact the proposed findings. The City respectfully asks that the OIG fully and carefully consider the responses and supporting documentation that has been provided. The City further requests that the OIG prepare revised findings that are shared with the City of Cleveland prior to issuing a final Audit Report.

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Should the OIG have any questions regarding documentation submitted herewith, please continue to direct all such questions to Teresa Beasley, Chief Assistant Law Director, or myself.

Sincerely,

Steven Sims

Director of Economic Development

cc: Jane L. Campbell, Mayor, City of Cleveland

Lana Vacha (Via Hand Delivery)

Richard Hendershot (Via Hand Delivery)

Rob Milburn (Via Hand Delivery) Stanley Gimont (Via Overnight Mail)

Pamela Glekas-Spring (Via Overnight Mail)

Lisa Hill (Via Overnight Mail)

#### **CITY OF CLEVELAND'S GENERAL COMMENTS**

Prior to addressing the OIG's proposed findings in detail, the City would like to provide the OIG with some general comments that relate to the findings in the Audit, as well as the form and basis of the City's Response. The City's general comments focus, include but are not limited to, the OIG's Executive Summary, Appendix A to the Audit, and the applicability of 24 CFR 597.200(e) to the City's Empowerment Zone.

#### OIG's Executive Summary

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The OIG includes the following language in the third paragraph of its Executive Summary: "Specifically, the City inappropriately used . . . of HUD funds that did not benefit the City's Zone program or were not matched with in-kind contributions." This is a broad and overreaching statement and language which leads the reader to believe that the projects assisted by Empowerment Zone funds did not warrant support, that the OIG encountered incidences or suspicions of wrong-doing or misallocation of resources, and that every project required an in-kind contribution match.

The City respectfully requests that the tone, character and language of the OIG's Executive Summary and any additional references in the Audit Report that the funds used did not benefit the City's Empowerment Zone program be modified so as to provide a more accurate and honest representation of what the audit potentially revealed and also because all such findings of the Audit are subject to review, consideration, interpretation and ultimately resolution by HUD.

#### Appendix A

The City challenges the OIG's interpretation of ineligible or unsupported questioned costs due to the inaccuracy of conclusions and additional supporting documentation provided by the City.

It is the City's understanding that "Ineligible Costs" are subject to modification pursuant to a future decision by HUD, as well as the City providing additional supporting documentation and possibly a legal interpretation or clarification of HUD's Departmental policies and procedures. Based upon documentation provided by the City, the OIG cannot draw this type of conclusion about the City's use of Empowerment Zone funds. As such, the City respectfully requests that Footnote 1 be rewritten as follows:

The costs are not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the cost. Ineligible cost requires a future decision by HUD program officials. This decision, in addition

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to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.

### Applicability Of 24 CFR 597 To The City of Cleveland's Empowerment Zone

A major question that has lead to potential audit findings on two large projects supported by Empowerment Zone funds relates to the applicability of 24 CFR 597, which is a regulation that restricts providing assistance to businesses and organizations that move into the Empowerment Zone, and that also result in a decrease of employment levels where the businesses or organizations were originally located. It is the City's position that the OIG erred in concluding that the prohibitions of 24 CFR 597 are applicable to the City's Section 108 loans and grants.

The City's journey to Empowerment Zone status is truly unique and wholly ignored by the OIG. Section 13301 of the Omnibus Budget Reconciliation Act of 1993 created a new Subchapter U of the Internal Revenue Code that authorized the Secretary of Housing and Urban Development (the "Secretary of HUD") to designate not more than 11 empowerment zones, of which not more than 8 may be designated urban areas. The City was not part of the original 8 areas that were designated as "Empowerment Zones". Although the Secretary began referring to Cleveland as a "Supplemental Empowerment Zone" as early as 1995, the Secretary of HUD's office did not attempt to designate Cleveland as an "empowerment zone" until April 15, 1998 and said purported designation did not become effective until January 1, 2000. One of the statutes contained within Part I ("Designation") of Subchapter U is the following "business pirating" prohibition:

- "(f) <u>Application</u>. No area may be designated under this section unless the application for such designation-...
  - (2) includes a strategic plan for accomplishing the purposes of this subchapter that-...
    - (F) does not include any action to assist any establishment in relocating from one area outside the nominated area to the nominated area, except that assistance for the expansion of an existing business entity through the establishment of a new branch, affiliate, or subsidiary..."

The Secretary of HUD has also adopted regulations based on the above-quoted statutory prohibition.<sup>2</sup> In 1998, Congress determined to insert a "business pirating"

<sup>&</sup>lt;sup>1</sup> 26 USCS §1391(f) (LexisNexis 2002).

<sup>&</sup>lt;sup>2</sup> 24 CFR §597.200(e) (5-1-01 Edition)

prohibition in the Title – 42 USCS §§5301 et. seq. – that includes Section 108 loans and grants. Obviously, if the previously referenced "business pirating" prohibition contained in Subchapter U applied outside empowerment zones (which it does not), Congress would have no need to insert the following new provision:

(h) Prohibition on use of assistance for employment relocation activities. Notwithstanding any other provision of law, no amount from a grant under Section 106 (42 USC §5306) made in fiscal year 1999 or any succeeding fiscal year may be used to assist directly in the relocation of any industrial or commercial plant, facility, or operation, from 1 area to another area, if the relocation is likely to result in a significant loss of employment in the labor market from which the relocation occurs.<sup>3</sup>

The reference to "a grant under Section 106" is to annual allocation commonly knows as Community Development Block Grants. However, the above quoted prohibition, by its plain language, is not applicable to loans and grants under Section 108. Since Congress saw fit to make specific reference to Section 106 – and not to Section 108 – the statute clearly excludes from its prohibitions the loan guarantees and EDI grants that serve as the source of the City's "supplemental empowerment zone" program. Further should the prohibition provided in 42 USCS §5306 apply to Section 108 loans, the relevant measure becomes significant loss of employment and not a standard based upon any reduction of employment at all.

The City believes neither the statutory nor regulatory "business pirating" prohibitions are applicable to Cleveland's disbursement of Section 108 loans and grants. Moreover, both the statute and the regulations speak solely to the contents of a strategic plan, and not to subsequent actions that may or may not conform to said plan. If Congress had intended the prohibition to extend to actual lending and granting decisions, it could have so provided; to date, it has chosen not to do so.

Based upon the foregoing, the City concludes that it is not subject to 24 CFR 597.200(e) and if subject to this regulation, the same was not effective until January 1, 2000, a date with which the OIG concurs, and a date after the City entered into certain contracts that allegedly violated 24 CFR 597.200(e). Therefore, it is inappropriate for OIG to retroactively apply and attempt to enforce regulations, which should affect the OIG's findings on Fairfax Renaissance Development Corporation's Quincy Place Project and Midtown Associates, L.L.C.'s Midtown Corporate Center Project.

<sup>4</sup> See 42 USCS §5306 (LexisNexis 2002).

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<sup>&</sup>lt;sup>3</sup> 42 USCS §5305(h)(LexisNexis 2002) (italics added)

**Supporting Binders** 

The City has provided substantial documentation to negate the findings and recommendations of the OIG. The majority of such information is referenced within the City's Response, however, not all exhibits are referenced in the Response, and included in the respective binders enclosed, labeled according to each of the ten (10) projects audited by the OIG.

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Detailed Responses to the OIG's Findings

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# FINDING 1 - Controls Over HUD Funds Were Not Adequate

The City disagrees that it (i) failed to maintain sufficient oversight of its HUD (Section 108 Loan Guarantee and Economic Development Initiative Grant) funds for its Empowerment Zone Program; (ii) inappropriately used HUD funds that did not benefit the City's Empowerment Zone Program; and (iii) lacked documentation to support that \$4,850,646 in HUD funds benefited the City's Empowerment Zone Program.

# Federal Requirements - Applicability of 24 CFR 570.203

The City's loan application to HUD ("Loan Application"), its 108 Loan Agreement, and relevant federal regulations  $\underline{allow}$  Section 108 funding to be used for community development and non-profit entities. The Loan Application does not specifically state that projects funded as Section 108 Business Loans  $\underline{must}$  be for-profit entities. The Loan Application provides the following:

Cleveland's proposal does not call for immediate lending to one or more specific development projects; however, each project will meet the program's general guidelines. Instead, Cleveland proposes two "generic" HUD 108 loan pools: one loan pool providing below-market loans to retain and attract small businesses; and, the other loan pool stimulating large scale real estate developments.

In addition, the Loan Application lists certain projects by name and includes a short description of each project. Some projects explicitly include the words "for-profit", while other projects do not include such language. The Fairfax Renaissance Development Corporation ("Fairfax") project does not include the words "for-profit".

The OIG incorrectly places a requirement on the City that does not exist in the City's Loan Application or 108 Loan Agreement. Section II, Part C, page 10 of the Loan Application provides that: "Borrowers must be in business for a minimum of three years and show a record of profitability or, in the case of nonprofit organizations, [an] ability to successfully manage fiduciary responsibilities." (Emphasis Added). In addition, the 108 Loan Agreement does not state, or make any mention of business loans or divide the Section 108 loan funds into any subcategory. The 108 Loan Agreement, Part II, Paragraph 15(a) provides in pertinent part:

Guaranteed Loan Funds shall be used by the Borrower to assist for-profit businesses, community-based development organizations, and non-profit organizations as sub-recipients in carrying out economic development activities and projects as authorized under 24 CFR §570.703(i). (Emphasis Added).

The OIG uses 24 CFR 570.203(b) to further its finding that the City inappropriately funded non-profit entities; however, the OIG ignores the full text of the federal regulations. The Section 108 eligibility provision at 24 CFR 570.703(i)(1) refers to 24 CFR 570.203 in its entirety with regard to the eligibility of economic development activities under the Section 108 Loan Program. The federal regulations at 24 CFR 570.203(a) — the applicable part of the federal regulations that the OIG failed to include in its analysis — reads:

Special economic development activities include: The acquisition, construction, reconstruction, rehabilitation or installation of commercial or industrial buildings, structures, and other real property equipment and improvements, including railroad spurs or similar extensions. Such activities may be carried out by the recipient or public or private nonprofit sub-recipients (Emphasis Added).

This language taken from federal regulations squares with the general language of the City's Loan Agreement. The federal regulations, in conjunction with the Loan Agreement support the propriety of the City making loans to non-profit entities. Therefore, it appears the OIG misinterpreted the City's ability to loan monies to non-profits.

# <u>Fairfax Renaissance Development Corporation – 24 CFR 597.200(e)</u>

The City believes it used Empowerment Zone funds efficiently and effectively when it allocated funds to Fairfax Renaissance Development Corporation ("Fairfax") to purchase land and construct a building to provide rental office space in the City's Empowerment Zone (the "Quincy Place Project"). The OIG's concern is that the project facilitated a reduction of employment outside the Empowerment Zone when Cuyahoga County relocated its Neighborhood Family Service Center to the Quincy Place Project which was assisted by Empowerment Zone funding. Therefore, the OIG incorrectly believes that 24 CFR 597.200(e), which is a prohibition against business relocations, should apply. However, the prohibition is not absolute. It provides two exceptions: (1) A business entity may expand by establishing a new branch, affiliate, or subsidiary so long as the expansion does not decrease jobs in the original location; and (2) There is no reason to believe that the new branch, affiliate, or subsidiary is being established with the intention of closing down the operations of the existing business entity in the area of its original location or in any other area where the existing business entity conducts business operations. 24 CFR 597.200(e)(1) & (2).

The OIG does not demonstrate that the relocation by Cuyahoga County resulted in reduced employment levels outside the Empowerment Zone. It merely notes that staff moved from a particular building outside the Empowerment Zone without

providing support or demonstrating that the employment levels of Cuyahoga County were actually reduced either at the particular building or overall outside the Empowerment Zone. As such, the City believes the finding is without basis.

The City believes the proposed finding as it relates to Cuyahoga County's relocation and the Quincy Place project exemplifies the strict, narrow, and often unreasonable approach that the OIG took in its work and interpretation of regulations. The Cuyahoga County Neighborhood Family Service Center was located at Quincy Place pursuant to an overall decentralization plan that the County undertook in response to Welfare Reform, and its initiatives to move people from welfare to work, and to better serve Empowerment Zone residents by locating vital social and employment services closer to them. The Request For Proposal outlining site parameters and evaluative measures for the new building to house the County's Human Services and Work and Training Programs is included in (Quincy Place Binder, Exhibit B).

There was much communication between HUD and the City with respect to the Quincy Place Project, and at no time was the City informed that such activity was prohibited. In particular, HUD's memo of December 4, 2000 authorizing the City to proceed with funding neither addresses any 24 CFR 570.207 concern and its applicability to the Quincy Place Project, nor raise an objection or query as to the applicability of 24 CFR 597.200(c). (Quincy Place Binder, Exhibit C). It is not surprising that HUD never raised a concern because the City believes that HUD understood that 24 CFR 597 was not applicable to the operations of the City's Empowerment Zone, particularly in light of the fact that HUD's authorization memo was dated a date after the purported effective date of January 1, 2000.

Based upon the information and documentation enclosed to contradict the OIG's contentions, the City respectfully requests that the OIG withdraw its findings that the Fairfax Renaissance Development Corporation inappropriately used HUD funds, as well as the use of the funds was not in compliance with 24 CFR Part 597.200(e).

# Fairfax - Expenses

The City did not inappropriately use \$2,328 of Empowerment Zone funds to reimburse Fairfax. The OIG improperly states that the funds were used to pay for meals catered at ground breaking and topping off ceremonies. It is the City's position that OIG applied the incorrect standard in its review. The events subject to this particular expense were organized to promote the imminent opening of a new community service facility servicing Empowerment Zone residents. This activity is allowable under Office of Management and Budget Circular A-87, Attachment B, Section 2, Advertising and Public Relations Costs. Included in the Quincy Place Binder, Exhibit D is a list of those invited to the public relations event and their affiliation with the Empowerment Zone.

The OIG further notes that the subject funds were not listed in the sources and uses of the contract funds as a specific line item. However, this is not a requirement and the cost in truth and fact was grouped in the budget line Item "V. E. Other".

Based upon the information and documentation enclosed to contradict the OIG's contentions, the City respectfully requests that the OIG withdraw its finding.

# Midtown Associates, L.L.C. - 24 CFR PART 597.200(e)

The City believes it used Empowerment Zone funds efficiently and effectively when it allocated funds to Midtown Associates to purchase land and construct and renovate buildings to provide commercial office space in the City's Empowerment Zone (the "Midtown Corporate Center Project"). The OIG is improperly attempting to apply 24 CFR 597.200(e), prohibition against business relocation, to this project.

First, the City has already argued in this Response with respect to the Quincy Place Project that 24 CFR 597.200(e) is not applicable to its initiatives. Second, if and when the City's Empowerment Zone became effective, which the City believes never occurred under law, the same would have occurred on January 1, 2000, a date after the effective date of the City's Empowerment Zone contract with Midtown Associates. As such, the Midtown Corporate Center Project preceded the time when the City's Empowerment Zone would be subjected to any such regulatory provision.

The aforementioned exceptions to relocation are especially pertinent to the City's Empowerment Zone's move to Midtown Corporate Center, should the regulation apply, which the City believes it does not. The relocation of the City's Empowerment Zone Office did not reduce the number of persons employed by the City of Cleveland, nor did the move cause the closing down of any existing City operation. Because of the space constraints, the desire to physically locate the Empowerment Zone Office within its boundaries, and the geographic proximity of the Midtown Corporate Center, the City determined that it was appropriate to move the Empowerment Zone Office there.

During the Exit Interview held on Friday, March 14, 2003 with the City, the OIG admitted they never conducted an employment analysis to determine as to whether or not the move of the City's Empowerment Zone resulted in a reduced employment level by the City. The City has enclosed supporting documentation that the move did not cause a reduction in employment by the City (Midtown Binder, Exhibits C, D, E, and F).

It should be noted that the City's move of its Empowerment Zone office occurred during the OIG's audit. The on-site staff of the OIG never cautioned the City that the move was considered a violation of any federal regulation including CFR 597.200(e). The City believes the proposed finding related to the relocation of the City's Empowerment Zone staff to Midtown Corporate Center provides a clear example of the

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strict, narrow, and often unreasonable approach that the OIG took in its work and interpretation of regulations.

The relocation of City Architecture to Midtown Corporate Center also did not violate CFR 597.200(e), as the OIG alleges. City Architecture was previously located at 3311 Perkins Avenue, an address within the Buffer Zone of the Empowerment Zone. The City had requested and was granted an amendment from HUD to extend approved economic development lending activities eligible under 24 CFR 570.703(I)(1) to the designated Buffer Zone. (Midtown Binder, Exhibit G). This agreement recognized the importance of revitalization of contiguous areas and allows the City to expand its lending activities to include the Buffer Zone. These businesses are eligible to receive all benefits that would be provided within the original Empowerment Zone boundaries. With these expanded benefits, a business located in the Buffer Zone. City Architecture was well within the boundaries of the Buffer Zone when it relocated to Midtown Corporate Center.

The OIG also asserts that documentation maintained by Midtown Associates did not show that City Architecture or the City's Empowerment Zone created or retained jobs. However, the City has provided documentation showing that the project retained 63 jobs while creating ten. (Midtown Binder, Exhibit P). The intent of the City's assistance for the Midtown Corporate Center, as shown in the City's contract with Midtown Associates, was to have at least 51% of the jobs created at Midtown Corporate Center made <a href="mailto:available">available</a> to low- and moderate-income residents. As such, the documentation called for within 24 CFR 570.506(b) will be provided for all jobs created by businesses assisted through the project. Moreover, the contract language gives Midtown Associates three years from completion of the project, or until December, 2004, to meet the job requirement.

The City fully anticipates that these numbers will be improved upon, as the local real estate market and economic conditions improve. Midtown continues to aggressively market the space. Letters of Intent have been received from no less than nine potential tenants dating from the project's inception to 2002. Prospective tenants included a non-profit agency, a State agency for rehabilitation services, a minority accounting firm, a communications company, a travel agency and a local community college. (Midtown Binder, Exhibit L). Jobs for Empowerment Zone residents certainly would have resulted if any of these firms chose to locate their offices in the Midtown Corporate Center.

The current shortfall reflects the fact that Healthsync.com entered into a lease with Midtown Corporate Center for 17,100 square feet of built-out space, but it unfortunately went bankrupt shortly after moving into the space. (Midtown, Binder, Exhibit M). Within the business plan for Healthsync.com, it is clear that there was the expectation for at least 60 jobs to be created. (Midtown Binder, Exhibit N)

Nevertheless, this clearly demonstrates that the City's Empowerment Zone planned to assure that the public benefit criteria would be met.

Based upon the information and documentation enclosed to contradict the OIG's claims, the City respectfully requests that the OIG withdraw its findings that the Midtown Associates, L.L.C. inappropriately used \$874,039 of Empowerment Zone funds, and the use of the funds did not meet 24 CFR Part 597.200(e).

# Lassi Enterprises, L.L.C. -24 CFR Part 570.209(b)(3)

The City believes it did maintain adequate controls over the Lassi Enterprises, L.L.C. ("Lassi") Project and that it did not inappropriately use HUD funds. In addition, the City believes it did and continues to follow and adhere to federal requirements when it provided Empowerment Zone funds to Lassi for the acquisition of land.

The OIG is incorrect with respect to its statement that the subject parcels of land were acquired with no specific proposed use. The City's Grant Agreement, Section 13(3)(c), titled 108/EDI Acquisition and Development Loans for Businesses allows the City's Empowerment Zone to provide assistance to "carry out land assembly and site development costs for major new industrial, research, or institutional development limited to the Empowerment Zone target area." The City's Grant Agreement defines specific proposed use as a "major industrial, research, or institutional development." The use of these funds is regulated by 24 CFR 570.209(b)(3)(ii)(D) and only calls for a specific proposed use.

To fully understand the proposed specific use of the Lassi Project, some background is necessary. The entire Lassi Project involves the acquisition, remediation and demolition of approximately 13.8 acres of land and property along the Euclid Corridor east of East 55<sup>th</sup> Street (the "Target Development Area") for the development of a technology center. Lassi, a subsidiary for Midtown Cleveland, was formed to acquire certain land for the development of a technology industrial park. Prior to the parcels being acquired and prior to the City obligating any Empowerment Zone funds to the project, Lassi, in conjunction with Midtown Cleveland, laid out its Master Development Plan for its Technology Park to the City.

Midtown Cleveland, through Lassi, began generally acquiring vacant and underutilized parcels in the Target Development Area to ready those parcels for the development of a center for leading Northeast Ohio-based technology center projects.

Midtown Cleveland has divided the development of the Midtown Technology Center into two separate phases. Phase I called for the acquisition, demolition and remediation of certain parcels on 7.5 acres in the Target Area located between East  $57^{th}$  and East  $61^{st}$  Street bounded by Euclid and Chester Avenues to make ready this land for the renovation of a historic building into 400,000 square feet of office and laboratory

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buildings. Midtown Cleveland, under the auspices of Lassi, purchased the subject parcels for the construction of 100,000 square feet of office and laboratory space in Phase II of the project. It is estimated that the project will create at least 100 full time jobs.

Included with the Lassi Binder is the documentation supporting this claim and the same is explained below.

- In January of 1997, Midtown completed its physical plan titled "Midtown 2000: Understanding, Rediscovering and Envisioning our Community." On the page titled "Upper Euclid: Opportunity," Midtown Cleveland identified the 2.1 acre site for future development. (Lassi Binder, Exhibit A).
- In the revised edition of this plan published in July of 1998, Midtown Cleveland furthered defined the use for this site by placing a building's footprint on it. (Lassi Binder, Exhibit B).
- In its application for the Empowerment Zone Acquisition and Development Zone Loan dated March 19, 2001, Midtown Cleveland attached a project description that identified the use of the site for Phase II of the Midtown Technology Center development. Not only is this description in the text, its use is also identified by various maps attached to the project description (Lassi Binder, Exhibit C).
- In the Executive Summary presented to the City's City Council for Ordinance 711-01, the City's Empowerment Zone office clearly identified the use of the land for the "construction of a high technology office and laboratory project ..." (Lassi Binder, Exhibit D).
- With internal Empowerment Zone documents describing the timeline of the Midtown Technology Center project, the City's Empowerment Zone clearly identified the purchase of the land for the project. (Lassi Binder, Exhibit E).
- In the Meeting Minutes from the Midtown Cleveland's Land Sub-Committee, when discussing the purchases of the properties, and the potential loan in the section titled "DiGeronimo Purchases" said acquiring the land was needed because "Creation of the site (is) necessary for the construction of a high technology office and laboratory project along the south side of Euclid Avenue as an important phase of the Midtown Technology Center." Based upon this recommendation, the Land-Sub-Committee passed a resolution supporting the organization's involvement in the project on October 11, 2001. (Lassi Binder, Exhibit F).

- On Thursday, November 8, 2001, Midtown Cleveland's Executive Committee adopted the Land Sub-Committee's resolution providing the organization's full approval for the project identifying an end use as the Midtown Technology Center. (Lassi Binder, Exhibit G).
- Finally, Midtown Cleveland again reasserted in a letter to the former City's Acting Director that it always intended the site to become part of the Midtown Technology Center. (Lassi Binder, Exhibit H).

The apparent concern of OIG was the fact that the subject property had not yet been developed at the time of the Audit. Although Lassi has focused primarily on Phase I of the Midtown Technology Center. Lassi's development strategy did not result in the City providing Empowerment Zone funds for land where there was no specific use at the time of obligation of the funds, rather, just a delaying of the development of the particular parcels acquired. Lassi and the City are committed to the entire development of the Midtown Technology Center.

Based upon the information and documentation enclosed to contradict the OIG's contentions, the City respectfully requests that the OIG withdraw its findings that the Lassi Project inappropriately used HUD funds to acquire land, and there is a lack of documentation to support the City performed an analysis to determine the minimum level of public benefit would be achieved.

# <u>Fairfax Renaissance Development Corporation – Permissible Fees Under 24 CFR 570.205</u>

The OIG argues that the City inappropriately used \$328,636 of Empowerment Zone funds for land acquisition cost and architectural expenses related to the Quincy Place Project. It is the City's position that each of the items were properly reimbursed in accordance with its contract as "capacity building" pursuant to 24 CFR 570.205. If the OIG looks to 24 CFR 570.205, the costs are and were properly reimbursed by the City. The monies expended by Fairfax were used "to carry out management, coordination and monitoring of activities necessary for effective planning implementation". The Empowerment Zone funds used to reimburse Fairfax were necessary and reasonable, and the same were adequately documented. The land purchase referred to in the Audit was acquired by Fairfax pursuant to its Master Plan, a copy of which is included in the Fairfax Binder, Exhibit A. Because the Empowerment Zone's funding used to reimburse Fairfax for "capacity building" are permitted under 24 CFR 570.205, the City respectfully disagrees with the OIG's finding.

# Fairfax Renaissance Development Corporation - Land Reversion

The OIG also improperly makes an over simplistic assertion that Fairfax, when it determined that certain land could not be used, donated the land to the City's land

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bank. The land acquired by Fairfax, <u>reverted back</u> to the City because Fairfax failed to develop the property according to the requirements set forth by the City. Enclosed in the Fairfax Binder, Exhibit B is a copy of the Deed to Fairfax from the City demonstrating the activities that were to be carried out by Fairfax with respect to the land. In addition, the City plans to incorporate the land into use as a public park, which is allowable under HUD regulations.

Based upon the information and documentation enclosed, to contradict the OIG's contentions, the City respectfully requests that the OIG withdraw its finding that Fairfax inappropriately used Empowerment Zone Funds.

## Center for Employment Training - Cleveland, Inc.

The OIG contends that the City reimbursed the Center for Employment and Training ("CET") for individuals who either did not live in the Empowerment Zone, or who were not authorized to attend classes, or who were not enrolled in the job programs offered by CET. The OIG draws its conclusion by asserting that the City's contract required the project to enroll 63 Empowerment Zone residents and the City's implementation plan for CET relates entirely to Empowerment Zone residents. (Emphasis Added).

The latter assertion conflicts with the Grant Agreement between the City and HUD, which states that EDI grant funds and matching Section 108 funds must be used to assist activities <u>located in or which serve</u> the Empowerment Zone. [Emphasis Added]. Moreover, Section 13(3)(b) of the Grant Agreement provides that residents of the Empowerment Zone will predominantly hold the jobs created or retained by assisted businesses. The OIG uses the word "<u>entirely</u>". The actual Grant Agreement language uses the word "<u>predominantly</u>". Clearly, the OIG uses language that does not square with the actual governing terms of the City's Grant Agreement.

Pursuant to the terms of the Grant Agreement, specifically Section 13(j) and 54 CFR 570.201(a)(2), the City entered into CET's contract specifically to increase Empowerment Zone residents' economic opportunities through comprehensive training in welding, machine tooling and graphic arts. Included with each training course are services that promote human development such as counseling, basic life skills and placement for CET graduates. CET is unique in the fact that trainees remain in the program until the trainee has mastered the required skills.

On the matter of the number of persons trained, CET's contract with the City is a cost based contract, not a performance based contract. This provides payment for both operational overhead costs as well as training for an undetermined amount of individuals. In a cost based contract, the training provider typically presents an estimate of the potential clients served. The contract between the City and CET does not fix the number of individuals required to receive training. Instead, there is a

reference to the number of people <u>expected</u> to be trained. During the contract period, CET did provide training to 32 eligible Empowerment Zone residents. For programs that provide job training, job readiness skills, résumé writing and a dedicated effort at job placement for the participant, the City received both a competitive rate for services provided as well as a successful training program for Empowerment Zone residents.

The OIG contends that CET lacked sufficient documentation for 7 participants that OIG believes did not receive proper authorization from the One Stop Career Center prior to attending the CET program. First, documentation has been provided to confirm that 2 of the participants received prior approval from the One Stop Career Center. (CET Binder, Exhibit E). Second, this was a policy established by the City, not federal regulations. With respect to any such policy, the same could be waived. Because referral by the One Stop Career Center was waivable at the discretion of the City to allow Empowerment Zone residents to take advantage of the program, the City should not be required to reimburse Empowerment Zone funds.

The OIG contends that funds should be disallowed for 5 participants that did not complete 10 days of training. At the time the City and CET entered into a contract, there was not a minimum number of days that a participant had to attend prior to CET being reimbursed by the City. However, the City later established a <u>policy</u> whereby participants had to complete a minimum of 10 days of training prior to CET receiving City funding. Again, the requirement is a City imposed policy, not a federal requirement. The policy was City imposed and as such, the City could waive the same. In that the 10-day requirement was waivable at the discretion of the City, the City should not be required to reimburse Empowerment Zone funds.

The OIG's assessment that the funding for the CET program, did not benefit Empowerment Zone residents is greatly mistaken. Since the inception of its program, CET has enrolled 261 Empowerment Zone residents that were provided technical training in the areas of machining, welding, shipping and receiving, printing and graphic arts (CET Binder, Exhibit F). Training in each area provides the opportunity for potential jobs that would pay in the upward range of \$9.08 per hour. CET offers training and job placement counseling to low- to moderate-income Empowerment Zone residents that often lack the requisite skills to obtain employment at higher wages. They typically obtain low-skilled, part-time jobs paying the minimum wage.

The goal of the Empowerment Zone is to uplift and provide jobs and training for Empowerment Zone residents. CET has accomplished this by providing training to both Empowerment Zone residents as well as low to moderate-income individuals. (CET Binder, Exhibit F).

To the best knowledge of the City, it did not under-report the use of program funds with respect to the CET Program.

Based upon the number of low- to moderate-income residents, which were primarily residents of the Empowerment Zone, that were trained by CET, the City respectfully requests that the OIG withdraw its findings with respect to the Center for Employment Training--Cleveland, Inc.

## **Vocational Guidance Services - Job Match Program**

At all times throughout the administration of the Vocational Guidance Services ("VGS") contract, the City used Empowerment Zone funds efficiently and effectively and has taken the necessary steps to assure that effective oversight and controls are in place at all times. The OIG contends that the City improperly reimbursed VGS for 50 non-Empowerment Zone residents participating in the Job Match Project. The City confirmed with VGS the appropriate and acceptable method by which to determine as to whether or not an enrollee is a resident of the Empowerment Zone. (VGS Binder, Exhibit C).

Of the 50 enrollees that the OIG represented to be non-Empowerment Zone residents, the City's records reflect that 16 were in fact residents of the Empowerment Zone. (VGS Binder, Exhibits F & G). Specifically, six were women who made the difficult decision to take residence within a Battered Woman's Shelter located inside the Empowerment Zone. (VGS Binder, Exhibit F). An additional 16 had residency on the opposite side of the street from the Empowerment Zone within the Buffer Zone. (VGS Binder, Exhibit H). It is difficult to believe that the OIG would argue that because a low- to moderate-income individual resided on the opposite side of the boundary line of the Empowerment Zone, the person was ineligible or costs related to the services are unallowable. The purpose of the City's Empowerment Zone is to remove the traditional barriers against upward mobility suffered by low- to moderate-income persons, not create new barriers because of the width of a street. It is the City's position that federal regulations and the City's Grant Agreement do not restrict use of funds solely to residents of the Empowerment Zone, and HUD's approval of the Buffer Zone recognized the need and importance of extending the benefits of the Empowerment Zone into surrounding areas.

The City's Supplemental Empowerment Zone Strategic Plan, in Section 1.04, it explicitly states:

The Grantee will abide by the provisions of the Cleveland Supplemental Empowerment Zone Strategic Plan and the City's EDI Grant Agreement with the U.S. Department of HUD as the Plan and EDI Grant Agreement apply to the program services provided herein, which Plan and Grant Agreement by this reference are incorporated as if fully rewritten herein.

In that the contract between the City and VGS is to be in accordance with the City's Grant Agreement, it is appropriate to turn to the language of the Grant Agreement for guidance. The Grant Agreement says: "EDI grant funds... must be used to <u>assist activities located</u> in or which serve the recipient's area qualifying for designation as an urban Empowerment Zone."

The OIG reasons, as it has in other findings within the Audit, that the City's plan for the Empowerment Zone only applies to persons residing within the Empowerment Zone in every instance, in every program, at all times. This clearly is not a proper reading of the Empowerment Zone's regulations nor the City's Grant Agreement. The City assisted activities located in the Empowerment Zone through its VGS Contract. The Grant Agreement, as controlling authority over the contract between the City and VGS, plainly allowed flexibility in how and to whom these programs were administered. To do otherwise, would clearly constrict these kinds of community-based development programs in a blinded fashion that would strangle the purpose and hamper the reach of the City's Empowerment Zone efforts.

Based upon the City's verifying of 16 of 50 enrollees residing within the Empowerment Zone, and the fact an additional 16 enrollees resided directly on the other side of the street from the Empowerment Zone boundaries, but within the Buffer Zone, the City asks that the OIG reduce the requested amount of reimbursement accordingly. Supporting documentation with respect to the City's findings can be found in the VGS Binder. (Exhibits F, G and H).

The OIG also takes issue with the manner in which the VGS classified direct and indirect costs. As a preliminary matter, VGS was assigned to support the contracted services with \$27,712 as an "in-kind" payment for indirect costs. The OIG asserts that documentation shows VGS paid \$1,722. The reality is that while the term "in-kind" was used, it is clear from the contract budget that the term was not intended to mean that VGS would supplement the project necessarily, but instead it would be responsible for certain overhead/indirect costs, should the actual program expenses exceed the funding provided by the Empowerment Zone.

VGS had initially projected that \$896,957 was required to fund this program. The contract budget identified \$869,245 as the City's Empowerment Zone allocation to VGS. In recognition of the projected \$27,712 shortfall, the City identified this as an inkind contribution to support indirect costs. The contract was completed at an amount substantially below the original projection of \$896,957. The total contract amount expended was \$850,935. Not only was the "in-kind" contribution not needed to support the program, there was no "in-kind" contribution requirement under the contract in any sense of the word. There also was no pro-rata allocation of the amount proposed in the contract. Accordingly, because the actual program expenses under the contract were less than the Empowerment Zone budget, there was no need or requirement for VGS to supplement the contract costs in any manner whatsoever.

The City does not agree that \$36,609 paid to VGS was inappropriate because certain indirect costs were incorrectly allocated to the contract by VGS. VGS's certified public accountant has provided a letter to confirm that as a regular part of its annual audit of VGS, which includes the required compliance testing related to OMBA-133, it reviewed the computation used by VGS for purposes of calculating the indirect rate that has been used by VGS in programs utilizing Federal funds. The CPA noted it agrees with VGS's computation and that the computation VGS annually prepared follows the basic premise of indirect cost under Circular No. A-122, that is those costs have not been assigned directly to awards or other work.

The "Indirect Cost Rate and Cost Allocation Plan" provides that an indirect cost rate of 19.86% applies to VGS projects. Section 2.03 of the contract between the City and VGS makes it perfectly acceptable for the grantee (the City) to set a predetermined fixed rate for computing indirect costs. Section 2.03 of the contract VGS defines indirect costs as those (a) incurred for a common or joint purpose benefiting more than one cost objective, and/or (b) not readily assignable to the cost objectives specifically benefited, without effort disproportionate to the results achieved.

On the matter of the OIG's concern about depreciation charges from VGS non Empowerment Zone funded entities, the external financial statements for VGS allocated depreciation across functional cost centers. However, VGS included all depreciation in the indirect cost pool and depreciation is not included as a direct cost to the federal grants. This treatment is allowable and complies with OMB Circular A-122 that specifically discusses the treatment of depreciation as an indirect cost. The direct cost base includes cost before any depreciation. Additionally, the portion that was specifically funded by other sources was correctly backed out of the pool.

On the matter of the OIG's concern about rents/and or direct costs from VGS non Empowerment Zone funded affiliated entities in its indirect cost allocation, VGS has treated the inter-company rents as credits as these rents offset certain expenses incurred. The amount is included as income from an affiliate and does not benefit VGS activity. As such, \$362,281 in rent was backed out of the indirect cost pool, which appropriately lowered the pool. Attachment A of OMB Circular A-122 discusses applicable credits and requires costs charge to be net of these credits. Further, the Sunbeam Shop expenses are included in the 1999 direct cost base. The costs of the Sunbeam Shop are included in the sheltered employment program. The direct cost base properly includes these costs as the Sunbeam Shop benefits from the activity.

Finally, the OIG raised a concern that the City used an outdated indirect cost rate for the two months of the VGS contract extension. The City's contract with VGS provides that the indirect cost rate that is negotiated is a predetermined fixed rate. Attachment A, Section E of OMB Circular A-122 further provides that predetermined fixed rates are not subject to adjustment. As such, the use of the December 31, 1999

financial statements is appropriate but should this not be the case, the period and associated cost involved would be dominium.

The OIG cites drug-testing fees as being inappropriately classified as indirect costs. The drug-testing fees were derived from services provided specifically for the contract by other agencies and stemmed from the cost of materials and equipment acquired for the purpose of the contract.

Information provided by VGS, show the drug test fee of a minimal \$50 included, but was not limited to, the cost of test materials, lab reports, verification and if necessary, the costs associated with a chemical dependency counselor; all of which are direct costs of administering the test (VGS Binder, Exhibit B). In turn, a specific costs center captures the aforementioned cost for all departments requiring drug testing.

To the best of its knowledge, the City accurately reports the information included in its June 2001 Report with respect to the VGS Program. Based upon the number of low to moderate-income residents trained by the program, which predominately were residents of the Empowerment Zone, the City respectfully requests that the OIG withdraw its findings with respect to Vocational Guidance Services.

# <u>IMR Global – Orion Consulting, Inc. and The Reserve Network Bank Teller</u> <u>Job Training</u>

The OIG incorporates several issues into its findings; the gist of its observations is that the Orion Project allowed non-Empowerment Zone residents to participate in bank teller training. As previously noted, the OIG incorrectly asserts that the City's Grant Agreement relates "entirely" to Empowerment Zone residents. The plain language of the Grant Agreement uses the term "predominantly". Furthermore, 24 CFR 570.209(b)(2)(iii) mandates that where an activity is expected to both create or retain jobs and to provide goods or services to residents of an area, the grantee must classify the activity under either the jobs standards or the area residents standard, but not both. This indicates that it is acceptable to include activities that provide goods or services to Empowerment Zone residents under the Grant Agreement umbrella. Certainly, providing job training that will result in a benefit to the Empowerment Zone area cannot be classified as a detriment.

The OIG relies upon Office of Management and Budget Circular A-87, Attachment A, Paragraph C (1)(a), which requires costs to be necessary and reasonable for proper and efficient performance and administration of federal awards. The code section goes much further to explain necessary and reasonable costs that the OIG has included in its discussion. For example, Paragraph C (3)(a) provides: "A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received."

In the case of the Orion Project, the benefits of (1) enrolling residents <u>predominantly</u> residing in the Empowerment Zone in a job training program, and (2) utilizing resources to train as many people as possible assured that the funds were used in an efficient and effective manner. The OIG contends that funds for two participants are ineligible because they lacked the proper authorization from the One Stop Career Center. Once again, this was <u>a matter of policy and procedure</u> imposed by the City, not federal regulations. Referral by the One Stop Career Center to the training was waivable, at the discretion of the City, and the City should not be required to reimburse Empowerment Zone funds for a matter of policy and procedure.

The OIG also contends that six participants were not Empowerment Zone residents. The City's investigation revealed that four of the six resided across the street from the Empowerment Zone and one of the two remaining resided in the Empowerment Zone at the time of enrollment (Orion Binder, Exhibits C & D). As stated earlier, it is difficult to accept the OIG's assessment that the public benefit for Empowerment Zone residents, as well as low to moderate-income residents, has not been achieved by the condition of an individual having residency across the street from the Empowerment Zone borders, an area officially designated as a Buffer Zone by HUD.

Based upon the number of low to moderate-income residents, which were predominately residents of the Empowerment Zone, that were trained by Orion and the City's authority under the Grant Agreement and federal regulations, the City respectfully requests that the OIG withdraw in its entirety the finding related to the IMR Global – Orion Consulting, Inc. and The Reserve Network Bank Teller Job Training project.

#### **Glenville Towne Center, Ltd. - Expenses**

The City did and still does maintain an adequate monitoring system with the appropriate oversight and controls with respect to the Glenville Towne Center Project. The City did not inappropriately use \$6,121 of Empowerment Funds to reimburse the Glenville Towne Center Project for costs that were not allowable.

The OIG improperly states that the funds were used to pay for meals catered at ground breaking and topping off ceremonies. It is the City's position that OIG applied the incorrect standard in its review. The event subject to this particular expense was organized to promote the imminent opening of a new community service facility servicing Empowerment Zone residents. This activity is allowable under Office of Management and Budget Circular A-87, Attachment B, Section 2, Advertising and Public Relations Costs. Included in the Glenville Towne Center Binder, Exhibit A is a list of those invited to the public relations event and their affiliation with the Empowerment Zone.

The events organized by the developer were to promote and advertise the new development and shopping center, a facility that eradicated long-standing blight in a

low-income neighborhood that is now providing basic commercial services to thousands of low- and moderate-income Empowerment Zone residents. Based upon the information and documentation enclosed to contradict the OIG's contentions, the City respectfully requests that the OIG withdraw its finding.

### **Public Benefit Analysis**

The City disagrees with OIG's contention that the City did not adequately plan for the Quincy Place Project, Midtown Corporate Center Project, Glenville Towne Center Project or Lassi Enterprises Project, and none of the projects achieved the mandatory public benefit criteria established by 24 CFR 570 and modified by the Grant Agreement.

Section 13(3) of the Grant Agreement establishes that the use of Empowerment Zone funds could be used "for an activity or activities (including eligible mixed use projects with housing components) that are eligible under Section 108 of the Act [the Housing and Community Development Act of 1974, as amended, 42 USC 5301-5320] and under 2 CFR 570.703." Section 13(3) later states that if certain conditions are met for certain activities, then HUD would consider the requirements of Section 108 and 24 CFR 570.703 to be met.

The activity referenced in Section 13(3)(b) of the Grant Agreement involves the use of Section 108 loan funds and EDI grants for businesses located in the Empowerment Zone. As summarized in this section, the activity calls for jobs created or retained by this activity to be predominantly held by residents of the Zone.

The "public benefit" rules for Section 108 and EDI expenditures are established under 24 CFR 570. Section 24 CR 570.209(3) says that public benefits for <a href="low-and-moderate-income-people">low-and-moderate-income-people</a> can come through the provision of jobs, either retained or created, or the provision of <a href="goods or services">goods or services</a>. (Emphasis Added). The same regulation further indicates that activities that receive assistance in excess of \$50,000 per job retained or created and activities that receive assistance in excess of \$1,000 per low-and moderate-income person who benefits from the provision of goods or services are eligible.

If the OIG, as the City did, looks at the public benefit criteria of 24 CFR 570.208, provisions of goods and services, then the OIG will see that the public benefit of provision of services was satisfied. Section 13(3) of the Grant Agreement establishes that the use of Empowerment Zone funds could be used "for an activity or activities (including eligible mixed use projects with housing components) that are eligible under Section 108 of the Act [the Housing and Community Development Act of 1974, as amended, 42 USC 5301-5320] and under 2 CFR 570.703." Section 13(3) of the Grant Agreement goes on to state that if certain conditions are met for certain activities, then HUD would consider the requirements of Section 108 and 24 CFR 570.703 to be met.

The activity referenced in Section 13(3)(b) of the Grant Agreement involves the use of Section 108 loan funds and EDI grants for businesses located in the City's Empowerment Zone. As summarized in this section, the activity calls for jobs created or retained by this activity to be predominantly <u>held by residents of the Zone</u> or the same be made available to low- and moderate-income residents.

#### **Quincy Place**

The Quincy Place project is one of the most catalytic projects within the Empowerment Zone, with other private and non-profit entities paying for the bulk of the project. It is perplexing to think that the OIG would criticize a project that has so comprehensively realized the intent behind the goals of the Empowerment Zone Program. Further, the City believes the proposed finding as it relates to Cuyahoga County's relocation and the Quincy Place Project exemplifies the strict, narrow, and unreasonable approach that the OIG took in its work and interpretation of regulations. The Cuyahoga County Neighborhood Family Service Center was located at Quincy Place pursuant to an overall decentralization plan that Cuyahoga County undertook in response to Welfare Reform, so as to better serve Empowerment Zone residents by locating vital social and employment services closer to them. The Request For Proposal outlining site parameters and evaluative measures for the new building to house the County's Human Services and Work and Training Programs is included in (Quincy Place Binder, Exhibit B).

There was much communication between HUD and the City with respect to the Quincy Place Project, and at no time was the City informed that such activity was prohibited. In particular, HUD's memo of December 4, 2000 authorizing the City to proceed with funding addresses any 24 CFR 570.207 concern and its applicability to the Quincy Place Project (see Quincy Place Binder, Exhibit C).

The Quincy Place Project provides vital services to thousands of low and moderate-income residents that live in the Empowerment Zone as a result of Cuyahoga County's Neighborhood Family Service Center that provides social services and employment and training programs as well as other community services being located within the building. Consolidation of counseling, job referral, and work-related services in a neighborhood location, in fact, is an objective set forth in both the Empowerment Zone Strategic Plan and Fairfax's Community Revitalization Plan.

The City's Empowerment Zone's participation in Quincy Place meets the public-benefit test of 24 CFR 570.209(3), namely support of an activity resulting in the provision of goods or services to low to moderate-income people. Since Cuyahoga County opened its Neighborhood Family Service Center in Quincy Place from August 2002 until January of 2003, it has already served 285 families from Fairfax, 435 families from Hough, and 680 families from Glenville. (Quincy Place Binder, Exhibit I).

Activities that receive Empowerment Zone funds must carry out one of the national objectives of benefit to low and moderate-income families or aid in the elimination of slum or blight. The Quincy Place project provides services to low and moderate-income families and eliminated an area comprised mostly of blight.

Based upon the information and documentation enclosed to contradict the OIG's contentions, the City respectfully requests that the OIG withdraw its findings The Empowerment Zone funds were used in an effective and efficient manner and the City need not reimburse funds.

# Midtown Associates, L.L.C.

The City, during the obligation and administration of the Midtown Corporate Center project, did use Empowerment Zone funds in an effective and efficient manner and Empowerment Zone residents were and remain primary beneficiaries of such funds.

The OIG includes a lengthy description of various subsections within 24 CFR 570, paying particular attention to 24 CFR 570.506 in its finding. The intent of the City's assistance for the Midtown Corporate Center, as shown in the City's contract with Midtown Associates, was to create 60 jobs, retain 55 jobs, and have at least 51% of the jobs made <u>available</u> to low and moderate-income people. As such, the documentation called for within 24 CFR 570.506(b) will be provided for all jobs created by businesses assisted through the project.

The contract language gives Midtown Associates three years from completion of the project, or until December, 2004, to meet the job requirement. The current shortfall in jobs created reflect the fact that Healthsync.com, which entered into a lease with Midtown Corporate Center for 17,100 square feet of space and planned to create 60 jobs, unfortunately went bankrupt shortly after moving into the space. (Midtown Binder, Exhibit N). This clearly demonstrates that the City planned to assure that the public benefit criteria would be met. The City fully anticipates the project numbers will be improved and the public benefit met, as the local real estate market and economic conditions improve.

Midtown Associates continues to aggressively market the space. Letters of Intent from no less than nine potential tenants dating from the project's inception to 2002 have been received. Prospective tenants that never moved into the center include a non-profit agency, a State agency for rehabilitation services, a minority accounting firm, a communications company, a travel agency and a local community college. (Midtown Binder, Exhibit L). Jobs for Empowerment Zone residents certainly would have resulted if any of these firms chose to locate their offices in the Midtown Corporate Center.

#### **Glenville Towne Center**

The Glenville Towne Center project is another catalytic project within the Empowerment Zone. It is difficult to understand the OIG's assertion that Glenville Towne Center did not provide any benefits to Empowerment Zone residents especially considering the goods and services aspect. Located in this neighborhood retail center is a laundromat, a restaurant, several clothing stores, and a bank. These are certainly types of retail establishments that would cater to Empowerment Zone residents.

As stated in the preceding section, Section 13(3) of the Grant Agreement establishes that the use of Empowerment Zone funds could be used "for an activity or activities (including eligible mixed use projects with housing components) that are eligible under Section 108 of the Act [the Housing and Community Development Act of 1974, as amended, 42 USC 5301-5320] and under 2 CFR 570.703." Section 13(3) later states that if certain conditions are met for certain activities, then HUD would consider the requirements of Section 108 and 24 CFR 570.703 to be met.

In effect, this section confers an automatic regulatory approval for any activities undertaken per the terms set forth in item 13(3)(a) through 13(3)(k). While these "special conditions" are a fair representation of the City's intent with respect to the Empowerment Zone program, they were never intended and do not read to delimit the City's ability to comply with Section 108 rules and 24 CFR 570.703 in ways different than those stated in the special conditions. 24 CFR 570 establishes "public benefit" rules for Section 108 and EDI expenditures. Section 24 CR 570.209(3) says that public benefits for low and moderate-income people can come through the provision of jobs, either retained or created, or the provision of goods or services. The same regulation further indicates that activities that receive assistance in excess of \$50,000 per job retained or created and activities that receive assistance in excess of \$1,000 per low and moderate-income person who benefits from the provision of goods or services are eligible.

In regards to the provision of jobs made available to low to moderate income people, Glenville Towne Center was very active in the solicitation of Empowerment Zone residents for jobs and partnered with Vocational Guidance Services ("VGS") to meet its job requirements. VGS works with retailers to keep apprised of their employment needs and screens potential employees for placement with various retailers. VGS has also hosted an Empowerment Zone Career Fair promoting employers located at Glenville Towne Center. Enclosed in the Glenville Towne Center Binder, Exhibit FF is correspondence received from Glenville addressing their recruitment efforts to hire Empowerment Zone residents.

In addition Section 13(3)(f) of the Grant Agreement permits the financing of retail development projects to eligible CBDOs under 24 CFR 570.204(c) to carry out eligible community economic development under 24 CFR 570.204(a)(2). This section

provides in pertinent part "Community economic development projects includes activities that increase economic opportunity, principally for persons of low and moderate-income, or that stimulate or retain businesses or permanent jobs". With respect to the City's use of Empowerment Zone funds to finance a retail development project, in compliance with 13(3)(f) of the Grant Agreement, and 24 CFR 570.204(a)(2), the City has satisfied the criteria established by federal requirements. Specifically, this section of the Grant Agreement does not mandate the creation of jobs. Nevertheless and in the best interests of implementing goals set forth in the City's strategic plan, this project has satisfied the public benefit of job creation by hiring at least 51 percent of low to moderate-income persons and making jobs available to low to moderate-income residents, and by providing service to low and moderate-income residents.

Coral Company provided the Empowerment Zone with an estimate of gross sales and transactions in the Glenville Towne Center based upon leases that require the tenant to provide this confidential information. (Glenville Towne Center Binder, Exhibit GG). According to Coral Company, based on a conservative analysis, the Glenville Towne Center generates nearly \$6.5 million in annual sales. Based upon an extremely conservative estimate of \$40 per transaction, this figure translates into annual sales transactions of 161,475 or 442 a day.

Working with Glenville Development Corporation, the Empowerment Zone Office conducted an informal survey of those shopping at Glenville Towne Center. Volunteers interviewed 173 shoppers over three separate periods between March 15<sup>th</sup> and March 18<sup>th</sup>. (The survey took place on Saturday afternoon between 1:00 - 3:00 P.M., Monday evening between 4:00 - 5:15 P.M. and Tuesday morning between 11:00 and 12:00 P.M.) The survey revealed that 53% of shoppers were Empowerment Zone residents who shopped at Glenville Towne Center on average 6 times a month. (Glenville Binder, Exhibit HH).

Based upon the above information, the City can conservatively estimate that 40% of the sales and transactions at the Glenville Towne Center are made to the City's Empowerment Zone residents. This means that of the roughly 161,000 annual transactions, Empowerment Zone residents make 64,400. In other words, the Glenville Towne Center provides goods 64,400 times a year to Empowerment Zone residents well above the standard of \$1,000 for every resident served. This should satisfy any concerns that Empowerment Zone residents do not benefit from the Glenville Towne Center. The Empowerment Zone further benefited from the project through the elimination of blight and the neighborhood revitalization that the project represents.

## Lassi Enterprises, L.L.C.

Lassi's development strategy did not result in the City providing Empowerment Zone funds for land where there was no proposed specific use at the time of obligation of the funds, rather, there just has been a delaying of the development of the particular

parcels acquired. Among other information, the Executive Summary prepared for Cleveland City Council clearly demonstrates the City performed an analysis to determine the minimum level of public benefit that would be achieved by Lassi. (Lassi Binder, Exhibit D).

Although Lassi has focused primarily on Phase I of the Midtown Technology Park, Lassi and the City are committed to the entire development of the Midtown Technology Park. Midtown Development Corporation has selected a co-developer for Phase I and substantially has funding commitments for this estimated \$18.0 million project, which is projected to create at least 100 jobs within 5 years.

# **Uptown Cleveland Security Corporation**

The City, at all times, did ensure that Empowerment Zone funds was used efficiently and effectively in the negotiation and implementation of the Uptown Cleveland Commercial Security ("Uptown") Contract. The City respectfully disagrees with the OIG's finding that controls over Uptown were not adequate. At the time the OIG reviewed the Uptown files, documentation, including payroll sheets, were not fully identified, located and/or considered. However, the City's Response includes the required documentation to support the distribution of funds, including payroll charges, to Uptown by the City pursuant to the terms and conditions of the Uptown Contract. The documentation was prepared in accordance with generally accepted accounting principles and was provided to the OIG in advance of this Response due to its volume (Uptown Binder, Exhibit B).<sup>5</sup>

The OIG further contends that the City executed a non-competitive contract with Uptown. This is not true. The City issued a Request for Proposal to procure these services. Uptown was the only responder to provide patrol cars, seven days a week between the hours of 3:00 p.m. through 7:00 a.m, which is the reason it was selected. The OIG apparently confused the fact that the contract was approved by an Emergency Ordinance with it not being competitively bid. Under the City of Cleveland's Charter, an ordinance that is effective sooner than 40 days following passage by City Council is an "emergency" ordinance. The designation of an ordinance as an "emergency" measure has no bearing on whether the contract was competitively bid. In response to still another contention by the OIG that the City did not perform a cost or price analysis, the City established the fairness and reasonableness of its contract award to Uptown based upon a comparison with the other bids received through the RFP process and that it met the requirements of 24 CFR 85.36 as well as 48 CFR part 31.

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<sup>&</sup>lt;sup>5</sup> In the OIG's verbal response to the documentation previously submitted by the City, the OIG misinterprets the terms and conditions of the City contract with Uptown, specifically the fee for services rendered concept, and has placed additional, inappropriate requirements on the City. Further, the OIG has ignored detailed documentation and has been unreasonable and inaccurate in their assessment of the documentation. The OIG's response is based upon an incorrect interpretation of one area of the contract. This misinterpretation has led the OIG to incorrectly ignore the City's detailed documentation. The OIG's response also inaccurately double counts the misinterpretation to the detriment to the City.

## **Glenville Development Corporation – Development Fees**

The OIG is incorrect in its in finding that the City inappropriately used \$179,604 of Empowerment Zone funds to reimburse the Glenville Towne Center, Ltd. for Development Fees. It is apparent that the OIG's field staff did not have a complete understanding of real estate Development Fees when they asked an Empowerment Zone staff member, "Can the Development Fee be bid out?" Development Fees are normal and customary in real estate transactions. A typical developer's fee is limited to a certain percentage of the project costs. In the Cleveland area, the average Development Fee ranges from 3%-10% of the total project costs. (Glenville Binder, Exhibits E & F). In this instance, the Development Fee paid on Glenville Towne Center was 2.49% of the total project costs.

While the Development Fee was not listed as a specific line item in the Sources and Uses, the same was contemplated at every stage of the transaction and negotiation and in fact, it was included in the "Other" line item on the Sources and Uses. The fee was placed under this heading to summarize a complex financing budget into a simplified presentation for the contract budget.

Included in Glenville Towne Center's proforma is the Development Fee and its calculation into the line item "Other". (Glenville Binder, Exhibit B).

The original Development Fee amount was to be \$292,855. However the transaction was structured so that if other areas of the project caused budget overruns, the Development Fee would be lowered accordingly. As a result, the Development Fee paid was only \$179,604.

The City also knew that this line item would payout a Development Fee because it constantly received budget updates containing line items that listed it. Enclosed in the Glenville Binder at Exhibits B & D are two examples of these updates dated June 6, 1997 and March 10, 1999. In each of these updates, Glenville Development Corporation and Coral Company listed the Development Fee under "Development Overhead." On the June 6, 1997 budget, Coral Company and Glenville listed the Development Fee as \$187,600. The March 10, 1999 budget listed the final Development Fee at \$179,600. The amount of the Development Fee decreased as the project budget tightened.

The OIG also contends that the City disbursed the Development Fee without adequate documentation. On the question of adequate documentation, the City paid the Development Fee based on invoices, submitted by Coral Company. The OIG did not challenge the validity of these invoices. Moreover, the work done by Coral Company alone on the project was more than sufficient to earn the fee paid.

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Glenville Towne Center, Ltd is a private limited liability company whose sole members are the Coral Company and Glenville Development Corporation. It should be noted that the City paid the Development Fee to Glenville Towne Center, Ltd., not to Glenville and Coral, as the OIG mistakenly states in the Audit. After Glenville Towne Center, Ltd. received payment, Coral Company and Glenville Development Corporation were paid their share of the Development Fee pursuant to the terms and conditions of the Glenville Towne Center Operating Agreement dated July 22, 1998, of which Glenville and Coral are the sole members. (Glenville Binder, Exhibit I).

Article 6, Section 6.01, of the Operating Agreement outlines the "Specific Duties, Rights, and Powers of Manager and GDC." In accordance with the Operating Agreement, Coral and Glenville were each assigned specific services as part of the development project including site assembly, planning and engineering, design and construction, marketing, leasing, facility management, financial management, and municipal approvals. (Glenville Binder, Exhibit G). Therefore, extending the audit process for transactions between private parties should not have been necessary as long as fair and reasonable services were provided for the sum paid. As such, the City should not be required to secure or submit any further documentation. Enclosed in the Glenville Binder, Exhibits J through Y is documentation supporting the performance of these activities by Glenville and Coral. Not withstanding the above argument, the and Coral Company have both documentation to justify their respective shares of the Development Fee.

In conclusion, the City's position is that the Glenville contract did provide for the payment of Development Fees in the Sources and Uses of Funds and the funds were distributed with adequate documentation.

## **Hough Area Partners In Progress**

Throughout the implementation of the Hough Area Partners in Progress ("HAPP") contract, all Empowerment Zone funds were used efficiently and effectively, and to the best of the City's knowledge, the City's use of Empowerment Zone funds were not underreported to HUD in its June 30, 2001 Annual Report.

The City has provided documentation that shows, per the contact between the City and HAPP, that \$25,000 of the funding was provided from HHS Title XX grant money, not Economic Development Initiative Grant funds, lowering the amount the OIG had the authority to audit from \$610,506 to \$585,506. (HAPP Binder, Exhibits B and C) Throughout the audit process, the City has provided documentation supporting \$583,654 of costs for the HAPP project.

With the current assessment of the City's processes and controls, additional procedures and controls, to the extent required, will be implemented to ensure that the

City continues to accurately report the sources and uses of program funds and accomplishments for HAPP throughout the duration of the HAPP contract.

# Conclusions

# Finding 1 A-G Recommendations

The City disagrees with the OIG findings and respectfully asks that the same be withdrawn and/or reduced, as supported by the documentation provided with this response.

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# Finding 2 - The City Inaccurately Reported the Accomplishments of Its Empowerment Zone Projects

The City agrees that improvement can be made in its reporting within its Annual Report. However, some of the historical issues with the reporting dealt with confusion concerning the reporting structure required by HUD. The City prepared its June 30, 2001 Annual Report under a framework it believes HUD recommended.

As a result of preliminary discussions with the OIG, the recommendations set forth in the Audit, and to allow for proper planning for the Empowerment Zone's expiration on December 31, 2005, the City has engaged an outside consultant to review the Empowerment Zone's processes and controls and reporting mechanisms, so as to implement modified and new ones, where needed, and assure that the City's Empowerment Zone continues to operate efficiently and effectively and in full compliance with requirements.

The issue with the reporting format was corrected in the June 30, 2002 Annual Report. In addition, the City has been working to gather the appropriate information that will be used for future reporting. Through the full understanding of the reporting requirements, the involvement of the outside consultant and newly implemented information gathering procedures, the City is committed to accurately reporting program accomplishments in future reports.

The City will implement procedures and controls to verify the accuracy of information submitted to HUD, and ensure that the staff responsible for preparing the Annual Report use actual verified accomplishments to report each project. Further, the City is committed to verifying and correcting, where needed, the progress, outputs, milestones and sources and uses previously reported to HUD on various projects to the extent possible and practical.

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# FINDING 3 - The City Provided HUD Funds to Projects That Have Not Benefited Zone Residents Or Benefited Only 25 Percent of Zone Residents

The City is proud of the Empowerment Zone's progress and remains committed to the original strategic vision and its vitally important thrusts in the areas of economic development, labor force development, and community building. All areas that comprise the Empowerment Zone have seen measurable revitalization that both specifically and generally benefited Empowerment Zone residents well beyond any individual project and the singular and simplistic measure the OIG used.

The OIG focuses on the Quincy Place, Lassi and Glenville Projects and makes an assertion that because the individual projects may not have met each and every contractual or regulatory requirement at this time, the projects did not benefit Empowerment Zone residents or only benefited 25% of Empowerment Zone residents. The City believes to the contrary that each of the Empowerment Zone Program projects individually and collectively has provided substantial benefits to Empowerment Zone residents.

The City's Empowerment Zone consists of neighborhoods characterized by high levels of unemployment, poverty and blight. The City has worked diligently to create a context that allows Empowerment Zone residents to improve their community and life potential by helping them gain access to resources that include jobs, money, information and clout – all things that enable one to take control of one's life and improve one's lot. The benefit that the Empowerment Zone provides is best measured by the success of an approach to strengthen families and the individual's basic support systems.

Jobs are critical but cannot be considered in a vacuum. In addition to generating employment for residents, any meaningful employment strategy must also address those factors that diminish or enhance the economic opportunities of a community or its residents including the service needs of neighborhoods and area businesses, and the ability of residents to qualify for - and keep - those jobs. These concerns have been the further focus of the City's Empowerment Zone Program.

The City has provided loans and grants, job training programs, and goods and services through retail developments while strengthening the local CDC's confidence and capacity to undertake and successfully complete major development projects. The City's Empowerment Zone's impact is seen, felt, and will last long beyond the funding period. The OIG's proposed finding also contradicts the Congressional intent of the Empowerment Zone and HUD's implementation of the program. Moreover, the OIG's narrow interpretation of public benefit severely constricts necessary community-based development programs in a blinded fashion that strangles the purpose and hampers the reach of urban revitalization efforts.

Quincy Place provides significant benefit to Empowerment Zone residents through having the County's Neighborhood Family Services Center located there. The residents now have more convenient accessibility to social and employment and training services, and the building is a symbol of revitalization while serving as an anchor for additional development that is planned for the area. Similarly, Glenville Towne Center is located in the heart of the Empowerment Zone, and provides a retail-shopping venue that did not previously exist and is built in a place where previous slum and blight conditions largely existed. Now Empowerment Zone residents have an asset in their neighborhood that was needed and provides vital services. This has added a sense of economic vitality to the Empowerment Zone. Further, the Lassi Project a.k.a. Midtown Technology Center will spur jobs and serve as a catalytic project that will result in additional business and neighborhood investments. The City strongly asserts that Empowerment Zone residents have and will continue to greatly benefit from the three projects cited, well beyond the measure and perspective taken by the OIG in its Audit.

With regard to the OIG's contention that none of the contracts required the projects to create jobs that will be predominately held by Empowerment Zone residents, the OIG admits that the City's Grant Agreement does not provide a definition for "predominately held" and that HUD must make a determination whether the City's use of HUD funds for the three projects was appropriate. We fully expect a favorable determination by HUD on this issue.

In addition, this Response previously referenced that Section 13(3) of the Grant Agreement establishes that the use of Empowerment Zone funds could be used "for an activity or activities (including eligible mixed use projects with housing components) that are eligible under Section 108 of the Act [the Housing and Community Development Act of 1974, as amended, 42 USC 5301-5320] and under 24 CFR 570.703." Section 13(3) goes on to state that if certain conditions are met for certain activities, HUD would then consider the requirements of Section 108 and 24 CFR 570.703 to be met.

In effect, this section confers an automatic regulatory approval for any activities undertaken per the terms set forth in item 13(3)(a) through 13(3)(k). While these "special conditions" are a fair representation of the City's intent with respect to the Empowerment Zone program, they were never intended and do not read to delimit the City's ability to comply with Section 108 rules and 24 CFR 570.703 in ways different than those stated in the special conditions.

Public benefit, as established by 24 CFR 570, provides the rules for Section 108 and EDI expenditures. Section 24 CR 570.209 (3) says that public benefits for <u>low and moderate-income people</u> can come through the provision of jobs, either retained or created, or the provision of goods or services. The same regulation further indicates that activities that receive assistance in excess of \$50,000 per job retained or created

and activities that receive assistance in excess of \$1000 per low and moderate-income person who benefits from the provision of goods or services are eligible.

For the public benefit of a project involving jobs, regulations and standards are set forth in 24 CFR 570.506(b) and 24 CFR 570.208. These passages indicate that projects determined to benefit <u>low and moderate-income persons</u> based on the <u>creation</u> of jobs can either involve projects where there is documentation showing that at least 51% of the new jobs have been <u>made available</u> to low and moderate-income persons, or projects where there is documentation showing that at least 51% of the new jobs are <u>held</u> by low and moderate-income persons. This is the case with respect to each of the projects referenced in the OIG's finding.

In addition, Section 13(3)(f) of the Grant Agreement permits the financing of retail development projects, such as the Glenville Project, to eligible CBDOs under 24 CFR 570.204(c) to carry out eligible community economic development under 24 CFR 570.204(a)(2). In fact, the Notice of Funding Availability dated May 17, 1995, which announced funds for the City's Empowerment Zone, included specific reference to such retail projects as an example of eligible activities.

If the OIG, as the City did, looks at the public benefit criteria of 24 CFR 570.208, provisions of goods and services, then the OIG will see that the public benefit of provision of services was satisfied. Finally, the Quincy Place, Lassi, and Glenville Projects each have until December 2004, to fulfill the public benefit requirement based strictly on job creation.

# Recommendations of Finding 3

In that Quincy Place and Glenville Towne Center have satisfied the public benefit criteria based on the provision of goods and service to residents and because the Lassi project has not yet been placed in productive service, the City respectfully requests that the OIG delete its recommendations in Finding 3 in their entirety.

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# FINDING 4 - The City Did Not Ensure That Program Income Was Remitted To The City

The City disagrees with the OIG's categorization of certain earnings of Fairfax Renaissance Development Corporation ("Fairfax") as program income and the need to remit such amounts to the City for deposit into a loan repayment account.

Because the City's Empowerment Zone, as set forth in its Strategic Plan, is to empower the Community Development Corporations ("CDCs"), the City's agreements with the CDCs provides that there shall be no program income in order that the CDCs are able to become self-sufficient when Empowerment Zone funding ceases. Indeed, a far-reaching goal of the City's Empowerment Zone is to create and support community-based projects and support capacity building within organizations, and ultimately to allow them to become self-sufficient.

What the OIG defines as "program income" is excluded from that definition under 24 CFR 570.500(a)(4)(ii) or 24 CFR 85.25. The OIG also contends that Fairfax Renaissance Development Corporation was fully funded with Economic Development Initiative Grant funds from the City's Empowerment Zone Program and Community Development Block Grant funds. This simply is incorrect. As such, it is highly questionable that any portion of the Development Fee should be considered program income, since it is possible non-federal funds supported the activities that generated the so-called program income. FRDC has provided information to show that since 1997, it received operating funds from sources other than the Empowerment Zone and CDBG to meet its budget expenses including payments for salaries. (Fairfax Binder, Exhibit F).

Additionally, the OIG admitted at the Exit Interview held with the City on Friday, March 14, 2003 as discussed in the proposed finding that it was unable to determine what portion of any such Development Fees might apply to the Empowerment Zone. The OIG simply makes a gross calculation, attributed the entire amount in its finding related to the Empowerment Zone, and recommends that the City resolve the matter with HUD. This certainly does not appear to meet professional standards of auditing.

Should the Development Fee be properly classified as program income, which the City believes it should not be classified, the City has several options under federal regulation on how to treat program income earned by subreciepents including allowing them to retain any such amount. The original proposed treatment of program income, as included in the City's Grant Agreement with HUD and between the City and Fairfax, dates back to 1995-1996 and was a policy decision; not a regulatory requirement. The policy was established to provide a possible additional revenue source that might be needed to support the City's loan repayments to HUD.

The City remains committed to capacity building and ensuring that CDC's can sustain their work beyond the life of the Empowerment Zone funding. The City supports allowing Fairfax to retain project Development Fees, it sees no conflict with HUD regulation or the intent of the Empowerment Zone Program in so doing. The City will verify through its outside consultant that the Empowerment Zone Program will generate sufficient sources to repay the City's obligation to HUD without requiring that CDC's remit program income to the City for deposit. Further, at the time the policy was considered, the City neither anticipated that the CDC's would earn Development Fees on projects or that such fees might be categorized as program income.

The City believes that it is inappropriate and unnecessary to require the City to deposit any amount of money from non-federal funds related to any portion of the Development Fees earned by Fairfax that may or may not be properly considered program income.

## Finding 4 Recommendations

The City disagrees with the proposed finding and believes that the OIG should resolve the question based upon the above analysis by City and supporting documentation and not refer to HUD for resolution. Therefore, we respectfully ask that the finding be removed because the Development Fee is not program income, the remittance of program income is a matter of policy and not regulation, and the OIG failed to specify what portion of the Development Fee, if any, would be allocable to the Empowerment Zone Program.

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# **MANAGEMENT CONTROLS**

As a direct result of preliminary discussions with the OIG, the recommendations set forth in the Audit, and to allow for proper planning for the Empowerment Zone's expiration on December 31, 2005, the City will (1) review the Empowerment Zone's processes and controls and reporting mechanisms so as to implement modified and new ones, where applicable, and assure that the City's Empowerment Zone continues to operate in full compliance with the EDI Grant Agreement, as well as applicable federal and state regulations and City ordinances; and (2) appoint a new Director to oversee and manage its Empowerment Zone; and (3) enhance management and oversight of the Empowerment Zone.

The City has engaged an outside consultant to review and analyze the Empowerment Zone's processes and controls and to make recommendations where necessary. As part of this review process, the consultant will provide assistance to the City's Empowerment Zone in the following six areas:

#### 1. Procedures and Controls

The consultant will assess existing processes, procedures and controls of the City's Empowerment Zone and provide the City with recommendations to improve and enhance our operations.

# 2. Contract Review

The consultant will evaluate the City's Empowerment Zone's current loan and grant portfolio to assure compliance with the contract and to ensure that appropriate monitoring and reporting processes exist, and that provisions required under federal, state and local regulations are incorporated into the agreements, as necessary.

# 3. Risk Analysis

The consultant will perform a risk analysis of the City's Empowerment Zone's current loan portfolio and collateralization of loans that will confirm (i) that the borrower's assets are sufficient to meet its obligations to the City; (ii) that the City is adequately secured; and (iii) that the current and future loan portfolio revenues are sufficient to meet the repayment schedule between the City and HUD.

## 4. Implementation of Corrective Actions

The consultant will assist in the development of an action plan to implement operational recommendations with which the City may concur.

## 5. Outcome Evaluation

The consultant will develop a comprehensive evaluation system that will capture the programs and activities that lead to key accomplishments as needed.

# 6. On-Going Consultation

The consultant will provide on-going consultation and guidance with new projects within the City's Empowerment Zone and to assist implementation of the recommended processes and controls.

Each of these steps are intended to assure an efficient and effective program and that program operations include the appropriate use of funds and benefit the Empowerment Zone, that data included in the Annual Report is valid and reliable, that the program complies with all applicable laws and regulations, and that resources are properly safeguarded to include the appropriateness of expenditures and supporting documentation and that the Grant Agreement and City contracts are understood, followed and/or amended, where appropriate.

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